

Prospects and Problems of Bilateral Trade Agreements

Trade agreements can potentially be a powerful instrument for trade expansion and economic growth. Merits of trade integration are well documented but the claims regarding their benefits have often been exaggerated. Empirically, it is hard to prove that trade integration enhances broad-based economic growth. However, it is equally true that no country has achieved broad-based economic growth by introducing trade restrictions and tariff protection measures and especially for developing countries it is difficult to design and implement policies that help them reap the benefits from trade integration. They should be particularly careful not to compromise the policy space they require to achieve human development objectives based on the principles of equity, empowerment, productivity and sustainability.

Sri Lanka is the first country in South Asia to liberalize trade beginning the late 1970s. Since then the trade has been broad based and by 2008² value of Sri Lanka's trade with outside world amounted to US\$ 8137 million and imports to the value of US\$ 14,008 million. Sri Lanka's contribution to the global trade is of no significance, as it contributes only 0.06 percent to the world trade³. Out of the total exports agriculture accounts for 23 percent and textiles and garments contributes to another 43 percent of all exports⁴ the bulk of textiles and garments find its markets in the European Union (EU) and United States of America (USA). The exports to EU have been facilitated primarily by General System of Preferences (GSP)⁵ arrangement. Bulk of agricultural exports consists of tea, spices and coconut products.

Sri Lanka as a signatory to the World Trade Organization (WTO) benefits from arrangements made under the global system of trade preferences (GSTP). Additionally a number of bilateral and multilateral arrangements have been entered into with the neighbors and the regional groupings with the aim of securing better markets. The most significant

trade arrangements entered into during the recent past are the Agreement of SAARC preferential trading arrangement (SAPTA), Asia Pacific Trade Agreement (APTA), Indo Lanka free Trade Agreement (ISFTA) and Pakistan Sri Lanka free Trade Agreement (PSFTA).

Indo-Lanka free trade agreement has been commended as a prudent arrangement made for the enhancement of trade between a fast growing industrial giant and a neighboring small agrarian economy. Sri Lankan side envisage to benefit adequately from this arrangement as they have the advantage of establishing access to a fast growing market with more than one billion population. Considering the international price competitiveness of Indian - made machinery and equipment, the Indian side considered to exclude those items from the 'preferential treatment list'. Therefore the Indian side disregard the growing trade balance between the two countries on account of increased trade of machinery and equipment as those items de linked from the normal preferential trade in goods list.

Advocates of the Indo-Lanka free trade agreement anticipated sharing of benefits of expanding trade between two traditional trading nations attributed to the new economic prosperity emanate from the openness and free trade regimes.

Dynamism of the new trading arrangements enjoyed during the first year of implementation of the agreement turned in to vinegary as some exporters of non traditional items such as tea found complications in reaching the target markets of India. Though fundamentals of free trade enshrined in the general agreement signed between the parties, the rigidities of entry point regulation at the State Government level prohibited the easy passage of goods to the Indian markets. Tea exports to India for instance, failed to find an easy passage as the protectionist measures practice.

Dr. R. M. K. Ratnayake¹

*Former Secretary,
Ministry of Trade,
Marketing Development,
Co-Operatives and Consumer Services.*

Negotiation saved the spirit of the agreement and the government of India decided to resolve the issue by agreeing to setup dedicated entry points for certain traded goods of sensitive nature.

Economic and trade benefits are not the only consideration embodied in most bi-lateral agreements between nations. In the hind side, bi-lateral agreements are govern by, political considerations and they play a crucial role in shaping and succeeding its implementation. Indo-Lanka free trade agreement for example had run into some miss fortunes befall as to changes occurred in the reign of management of commerce. With the fervent hope and expectation to convert the free trade agreement into a Comprehensive Economic Partnership Agreement (CEPA), both parties met in several rounds and ironed out some burning issues before presenting a final draft for consideration of the political leaders of both countries.

The minister of Commerce and Trade⁶ in the incoming Government of 2004 had expressed dissenting views on CEPA based on the representations made by some private sector industrialists and decided to delay the finalise agreement pending an investigation into certain matters raised by the domestic industrialists.

At a meeting with the Indian commerce secretary Hon minister of external trade confirmed that the CEPA agreement will be signed on the sidelines of the SAARC summit in Colombo⁷. The government yields to the pressure of some powerful individuals and manufactures on the premise that the proposed agreement would potentially harmful to the local industry and decided not to sign the agreement during the SAARC

summit. Therefore the signing of the agreement was postponed indefinitely, and the displeased Indian bureaucrats gradually showed their displeasure though this has not run into a trade war.

India remarked that the signing of the agreement would mark the over three years of discussions to boost trade and investment between the two countries with focus on developing Sri Lanka. They also considered this as a win-win situation to both the countries and both sides have agreed to reduce the negative lists to give a boost to trade and investment. Indian side proposed that the CEPA also aims at creating a more facilitating environment for Sri Lanka exports and seeks to remove some of the perceived impediments to exports from Sri Lanka. These include:

(i) a provision to identify and root out all non-tariff barriers.

(ii) CEPA provides for close corporation mechanism between Customs Authorities; for transparency of laws, rules and regulations through prompt publication, adoption of risk management techniques to allow expeditious clearance to low risk consignments adoption of paperless trading.

(iii) CEPA provides for a mutual recognition agreement (MRA) as well as adoption of common sanitary and Phyto-sanitary standards. As a result of this arrangement delays due to lab testing and certification processes will be avoided allowing Sri Lankan exports to enter India unhindered.

Even after postponing the signing of the comprehensive trade agreement (CEPA), attempts were made to simplify procedures and to resolve some inherent issues connected to trade surfaced under the FTA arrangement. To avoid some custom-related issues the Department of Commerce of the Ministry of Commerce and Industry of India on March 2008 issuing a notification amended in a schedule on exports and imports items under different HS codes⁸ and designated the port of Kolkata as the designated point of entry for some selected trading items such as all types of granites and marbles.

During the early phase of implementation of the free trade agreement, the Indian side complained on violation of the clauses relate to domestic value addition of some of the non-traditional items exported from Sri Lanka⁹. Export of refined copper alloys for example, Indian side claims that Sri Lanka has violated the conditions of value addition and alleged that the Sri Lankan trades imported the undervalued final product and re-exported to India making no value addition. Indian side also alleged that some of the exporters of copper products had no smelters installed in their factories to undertake any meaningful transformation of imported

Table 2: Major items, which recorded export growth (Value in Mn US\$)

Product Category	Description	2006	2007
151620	Vanaspathi	79.69	145.32
40	Rubber & articles thereof	19.02	35.44
151790	Margarine	23.18	25.04
090411	Pepper	13.23	18.33
230990	Animal feeds	4.31	12.57
151110	Crude Palm oil	5.54	10.11
0902	Tea	1.43	2.08
	Total	227.7	380.4

and its articles, Marbles, Lead oxide, Copper wire and Copper waste and scrap would not qualify duty concession treatment due to violation of the rules on value addition. The controversy greatly affect the trade and value of exports has dropped from US\$ 49 million in 2006 to US\$ 21 in 2007 and reduced capacities forced the closure of some factories.

Other major export items other than those listed in the above Tables, recorded negative growths at varying degrees due to a variety of reasons. Citing the injury criteria¹⁰ of the Trade agreement, the government of India in 2006 decided to review the position of preferential duty import of Vanaspathi and other bakery fats such as margarine to India.

The modus operandi proposed for export, discouraged the exporters and the value of exports fell from US \$ 122 million in 2005 to US\$ 79 million in 2006. Under duress, the Sri Lankan sides agreed to a quota of 250,000 mt of Vanaspathi and margarine exports to India under the provisions of the agreement and free apply quotas for imports such as Vanaspathi, Pepper, and Desiccated coconut products exports from Sri Lanka. "Threat of serious injury" means a situation in which a substantial increase of preferential imports is of a nature so as to cause "Serious injury" to domestic producers, and that such injury, although not yet existing is clearly imminent. A determination of threat of serious injury shall be based on facts and not on more allegations, conjecture, or remote or hypothetical possibility.

Table 1 : Major Items, which Recorded Export Decrease, Value in Mn US\$

Product Category	Description	2006	2007
7403	Refined copper and copper alloys, products	49.06	21.20
7605	-Aluminum wire.	25.00	0.00
72 TO 73	Iron or steel & its articles	6.93	4.99
7601	Aluminium products	3.19	0.18
68	Marble	22.69	15.79
282490	Lead oxide	4.69	3.18
740811	-Copper wire.	7.15	0.58
740400	Copper waste & scrap	5.34	0.27
	Total	124.1	46.2

r a w material. They expressed their concern over the export of items such as refined copper and copper alloys products, Aluminium wire, Iron and steel

"Critical circumstances" means the emergence of an exceptional situation where massive preferential imports are causing or threatening to cause "serious injury" difficult to repair and which calls for immediate action.

Products, which are otherwise uncompetitive, become competitive in term of landed price in the importing country by enjoying tariff concessions.

An examination of bi-lateral trade statistics makes it amply clear that the free trade agreements has been a win-win situation for both sides.

Indo-Sri Lanka bi-lateral trade agreement for example, even with the global economic meltdown the overall trade turnover reached US\$ 3265 million compared to US\$ 3266 million in 2007. This is almost a five fold increase from US\$ 658 million in 2000.

Preferential trade agreements are beneficial, though the success of implementation is mostly linked to the political understanding between the parties.

The success or failure of bi-lateral trade agreements therefore depends largely on the local political ideologies and alliances than the trade considerations and the evidence points that the frequent changes in policy and changing allegiance may harm bi-lateral trade relations.

Trade disputes under bi-lateral agreements which emanates from interpretational problems based on non tariff considerations may cause irreparable damage to economies with undiversified trade.

Footnotes :

¹ Former Secretary, Ministry of Trade, Commerce and Consumer Affairs

² Sri Lanka Customs data 2008

³ WTO statistics 2008

⁴ Composition of exports in 2008: agriculture 23%, textile and garments 43%, machinery and equipment 6%, rubber products 7%, diamonds and jewelry 5%, food beverages and tobacco 6%, petroleum products 3%, other industrial 6% .

⁵ Sri Lanka is the only outsourced manufacturing country in Asia which has signed up to 39 of the ILO conventions and is one of the only two countries in the world to have been granted concessions by the EU under GSP+ scheme for good governance. (See Department of Commerce web).

⁶ A meeting to review the Progress of CEPA was arranged between the two ministers of Commerce (Hon Jeraj Fernadopulle and Hon Kamal Nath) and relevant officials during the HE the Presidents Official visit to Delhi in 2005. CEPA agreement however has not finalized as yet.

⁷ The Times of India, statement by Mr. Pillai Secretary Commerce Government of India 9th July 2008.

⁸ S.O. (E) - In exercise of powers conferred by Section 5 of the Foreign Trade (Development and Regulation) Act, 1992 read with paragraph 2.1 of the Foreign Trade Policy- 2004-09, the Central Government hereby amends Schedule - I (Imports) of the ITC (HS) Classifications of Export and Import Items, 2004-09 as under: "Import of items under Exim Codes 25151100, 25151210, 25151220, 25151290, 68021000, 68022110, 68022120, 68022190, 68022200, 68029100, and 68029200 from Sri Lanka under the India-Sri Lanka Free Trade Agreement (ISFTA) is allowed only through the Port of Kolkata. In addition to the condition mentioned at 1 above, import of these items shall also be subject to all the conditions applicable on imports under ISFTA."

5. Rules of Origin criteria.

Wholly Obtained Products

All wholly obtained products such as tea, fish, spices etc. will be able to enjoy duty free benefits at each other's markets without difficulty, provided they are eligible for duty concessions.

Products not Wholly Produced or Obtained

These include the products manufactured using imported raw materials. In order to enjoy ISFTA benefits, the products should comply with the following criteria. The Domestic Value Addition (DVA) in the exporting country should not be less than

35% of the FOB value of the finished product and .HS Codes of the imported raw materials and the finished products should be different at 4-digit level. (Change of Tariff Heading criteria)

Cumulative Rules of Origin

The Cumulative Rules of Origin encourage the contracting states (India and Sri Lanka) to source raw materials needed for their exports from each other. Accordingly, an exporter has to show only a minimum DVA of 25% of the FOB value of the finished product, provided the raw materials imported from the other contracting state accounts for not less than 10% of the FOB value of the particular product. (In other words, the aggregate value addition should not be less than 35% of the FOB value of the finished product, while the DVA in the exporting country should be minimum 25% of the FOB value)

¹⁰ "Serious Injury" means significant damage to domestic producers, of like or similar products resulting from a substantial increase of preferential imports in situations which cause substantial losses in terms of earnings, production or employment unsustainable in the short term. The examination of the impact on the domestic industry concerned shall also include an evaluation of other relevant economic factors and indices having a bearing on the state of the domestic industry of that product.

"Threat of serious injury" means a situation in which a substantial increase of preferential imports is of a nature so as to cause "Serious injury" to domestic producers, and that such injury, although not yet existing is clearly imminent. A determination of threat of serious injury shall be based on facts and not on mere allegations, conjecture, or remote or hypothetical possibility.

"Critical circumstances" means the emergence of an exceptional situation where massive preferential imports are causing or threatening to cause "serious injury" difficult to repair and which calls for immediate action.