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Comprehensive Economic Partnership  
Agreement between India and Sri Lanka:  
Where does it lead?

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# Comprehensive Economic Partnership Agreement between India and Sri Lanka: Where does it lead?

**Biswajit Nag\***

## **Abstract**

India-Sri Lanka signed free trade agreement (FTA) in 1998. Looking at the success of the agreement both the countries engaged themselves in negotiating a 'Comprehensive Economic Partnership Agreement' (CEPA), which include trade, investment, and technology transfer etc. The CEPA negotiation was initiated in 2005 and concluded in July 2008, after thirteen rounds of negotiations. CEPA comprise of 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. Both sides had decided to sign the CEPA during the 15th SAARC Summit held in Colombo but due to reservations expressed by Government of Sri Lanka, the agreement has still not been signed. Reservations were based on two broad concerns: about the nature of the CEPA itself and that the drawbacks in the FTA should be dealt with first, prior to embarking on a CEPA. It is important to note that CEPA has made attempts to address both the issues. The paper analyses the positive and negative views about the current trade dynamics between these two countries and their possible implication in post CEPA period. The article also analyses various clauses imbibed in the agreement for services and investment issues.

**JEL Classification:** F15

**Key words:** Economic Integration, India-Sri Lanka Trade

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# **Comprehensive Economic Partnership Agreement between India and Sri Lanka: Where does it lead?**

## **1. 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 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. It has further increased to US\$ 2.7 billion in 2009. Looking at the success of the FTA both the countries engaged themselves in negotiating a 'Comprehensive Economic Partnership Agreement' (CEPA), which include trade, investment, and technology transfer etc. The CEPA negotiation has been initiated in 2005 and concluded in July 2008, after thirteen rounds of negotiations. CEPA comprise of 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. Both sides had decided to sign the CEPA during the 15th SAARC Summit held in Colombo but due to reservations expressed by Government of Sri Lanka, the agreement has still not been signed. Perhaps, the business community is still not clear about the gains and losses to be accrued due to CEPA. This requires more in depth study on the issue.

## 2. Trade Dynamics in Goods Sector

Sri Lanka embarked on a path of comprehensive economic policy reforms as early as 1977, becoming the first country in South Asia to adopt the export-driven growth strategies. The main objective was to give the economy an outward orientation for better integration with the rest of the world. Indian economy, on the other hand liberalized partially in 1980. Following the macroeconomic crisis in 1991 the Indian trade policy underwent reforms and the focus was shifted to - liberalization, openness, transparency and globalization. As a result of this gradual opening up of both the economies trade in goods between India and Sri Lanka picked up significantly.

As is noted from Table 1, India's exports of goods to Sri Lanka rose from US \$ 175.30 million in 1991 to US \$ 641 million in 2000-01 and then to US\$ 2827 million in 2007-08. On the other hand, India's import was mere US\$ 11.5 million in 1991 which rose to US\$ 45 million in 2000-01 and then to US\$ 631 million in 2007-08. Trade figures dropped during last two years which may be due to recession. Thus, the total goods trade taking place between the two economies more than quadrupled during 2000/01 to 2007/08. However, a careful analysis reveals that India's import growth (27%) was much higher than export growth (14.5%) in post 2000 period on CAGR basis<sup>1</sup>. This is the time when ISLFTA has become operational. Diagram 1 depicts the dynamics of trade clearly.

**Table 1: India's trade in goods with Sri Lanka (US \$ million)**

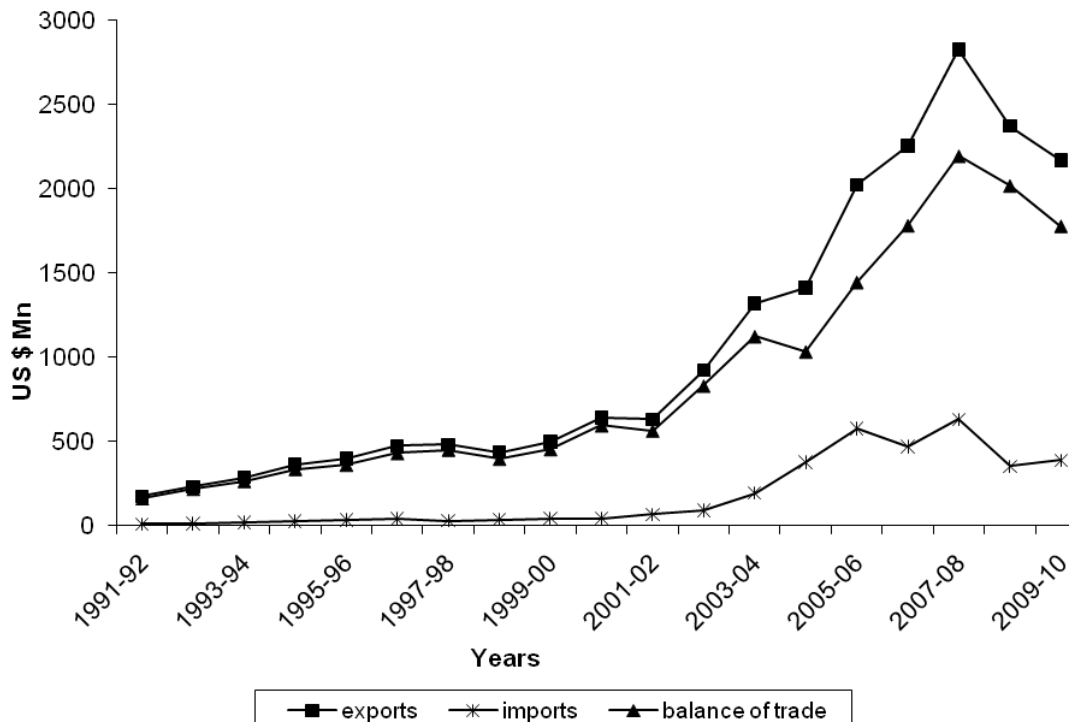
Year	Exports	Imports	Trade Balance	Total Trade
1991-92	175.30	11.53	163.77	186.83
1992-93	232.89	12.93	219.96	245.82
1993-94	286.60	19.97	266.63	306.57
1994-95	366.52	28.07	338.45	394.59
1995-96	399.74	36.29	363.45	436.03
1996-97	474.65	42.88	431.77	517.53
1997-98	482.35	30.24	452.11	512.59
1998-99	436.65	37.67	398.98	474.32
1999-00	499.77	44.29	455.48	544.06
2000-01	641.19	45.08	596.11	686.27

<sup>1</sup> During this time CAGR of India's export to world was around 17% and import from world was 19.66%.

**Table 1: India’s trade in goods with Sri Lanka (US \$ million) (contd)**

2001-02	633.00	67.58	565.42	700.58
2002-03	922.82	91.00	831.82	1013.82
2003-04	1320.10	194.87	1125.23	1514.97
2004-05	1412.60	378.24	1034.36	1790.84
2005-06	2024.37	577.62	1446.75	2601.99
2006-07	2254.06	470.31	1783.75	2724.37
2007-08	2826.61	631.44	2195.17	3458.05
2008-09	2372.60	353.59	2019.01	2726.19
2009-10	2170.35	390.22	1780.13	2560.57

Source: India Trades, CMIE



**Fig 1: India’s trade with Sri Lanka (value in US\$ million)**

Source: India Trades, CMIE

In the post- FTA period India has taken a lead over Japan with respect to share in Sri Lanka’s global import of goods. In 1999, India’s share was 9.5% in Sri Lanka’s total goods imports and it was the second largest importer after Japan. By 2005 India achieved a share of over 17.3% in Sri Lanka’s imports and became the largest importer. Since 2003, after all the Indian tariffs were reduced

to zero (except for items in the negative list) India has also become the third largest destination for Sri Lankan exports next to USA and UK. At 6-digit HS code, in 1999 Sri Lanka exported only 293 products. Its export basket got diversified significantly by 2004-05. By 2009-10, it exported 849 different types of goods. But though India enjoys about 24% of Sri Lanka's market share, Sri Lanka continues to be an insignificant source for Indian imports. As a result the trade balance between the two countries has been widening in favour of India. In 2007, Sri Lanka's adverse trade balance with India (US \$ 2195.17 million) was approximately 90% of her adverse trade balance with the entire world (US \$ 2392.21).

**Table2: Number of products Sri Lanka exports (at HS 6 digit level) to India**

Year	Number of products
1999-2000	293
2004-2005	811
2009-2010	849

*Source: Calculated from India Trades, CMIE*

Petroleum is the most important product exported by India to Sri Lanka. Its export value was insignificant in 2000 but picked up substantially in recent times. Apart from this, India exports pharmaceutical products, two wheelers, vehicles, woven cotton products, vegetables including onion etc. All these products experienced a steady rise in exports over the years. On the import side, India buys lot of rubber products, spices (cloves, pepper etc), animal feed, refrigerating equipments, electric wires etc. A more detailed observation shows that most of the major importable experienced steady growth only in last few years. Details are given in Table 3 and 4 below.

Sri Lanka's overall exports basket is quite concentrated. Only 20 commodities constitute almost 90% of Sri Lankan total exports. Textile, clothing and garments form a very major share of Sri Lanka's global exports. The important commodity groups of Sri Lanka's exports are tea, textile commodities, precious stones, Fish, Rubber, Edible fruits, Copper and copper products, Electrical and electronic

equipments etc. Out of the top twenty commodities exported by Sri Lanka to the world, India the major importer of rubber, spices, copper products etc. Import of copper products especially wire increased substantially in post FTA period. Refined copper (H.S. Heading 7403) and wire & cables of copper (H.S. Heading 7413) account for 16% of total copper imports from Sri Lanka in 2007. However, in recent times, copper import has been slowed down. The next big surge in imports was reported in the edible oils category (H.S. 15). In 2006 26% of total imports were explained by animal/vegetable fats and oils (H.S. 1516) which decreased to 17% (approx) in 2007. This is important to note that import share of vegetable oil and copper products have come down in recent times and new products such as refrigerating machineries, tugs and pusher craft, glass products etc have occupied higher share in 2009.

**Table 3: India's top 10 exports (H.S. 4 digit) to Sri Lanka as per 2009-10 (US\$ million)**

Product Code	Product Description	2000-01	2005-06	2006-07	2007-08	2008-09	2009-10
2710	Petroleum oils& oils obtained from bituminous minerals other than crude containing 70% or more by weight of these oils***	0.04	623.23	695	1094.7	730.3 2	551.51
3004	Medicaments for therapeutic/prophylactic uses in measured doses or in packings for retail sale	25.68	56.13	72.95	61.9	79.01	88.72
5208	Woven fabrics of cotton	15.78	28.73	37.23	47.49	62.77	65.25
8711	Motorcycles (including mopeds) and cycles fitted with an auxiliary motor, with or without side-cars;	16.14	63.77	80.91	53.65	63.44	63.56
8703	Motor cars & other motor vehicles for transport of persons(excl of 8702)including racing cars etc	1.45	70.11	95	68.93	67.87	63.41
9993	Special transactions & commodities not classified according to kind	2.39	10.93	13.29	2.88	7.74	54.92

**Table 3: India's top 10 exports (H.S. 4 digit) to Sri Lanka as per 2009-10  
(US\$ million) (contd)**

5205	Cotton yarn (other than sewing thread), containing 85% or more by weight of cotton, not put up for retail sale	20.73	22.06	34.46	38.36	37.95	43.69
0904	Pepper of the genus piper; dried or crushed or ground fruits of the genus capsicum or of the genus pimenta pepper :**	10.56	16.57	27.64	33.71	37.74	43.68
2304	Oil-cake and other solid residues whether or not ground or in the form of pellets, resulting from the extraction of soya bean	10.08	22.28	25.77	42.45	39.49	42.91
0703	Onions, shallots, garlic, leeks and other alliaceous vegetables, fresh or chilled	13.58	19.07	25.98	26.65	34.59	40.72

\*\* India mainly exports 090420 which is fruits of the genus capsicum or of the genus pimenta, dried or crushed or ground

\*\*\* India exports 271011 and 271019 which are superior kerosene oil, aviation turbine fuel, High speed diesel, motor spirit etc.

Source: Calculated from India Trades, CMIE

**Table 4: India's top 10 imports (H.S. 4-digit) from Sri Lanka as per 2009-10  
(US\$ million)**

Product Code	Product Description	2000 -01	2005 -06	2006 -07	2007 -08	2008 -09	2009 -10
2309	Preparations of a kind used in animal feeding		0.31	7.05	14.39	30.62	38.76
8904	Tugs and pusher craft				26.04		38.34
4001	Natural rubber, balata, gutta-percha, guayule, chicle and similar natural gums, in primary forms or in plates, sheets	0.3	2.74	15.59	16.56	13.91	28.41
0907	Cloves (whole fruit, cloves and stems) cloves (whole fruit, cloves and stems)	2.51	18.82	10.05	20.83	16.39	28.33
8544	Insulated (including enamelled or anodised) wire, cable (including co-axial cable) and other insulated electric conductors	0.02	18.17	34.96	35.05	29.62	24.87

**Table 4: India's top 10 imports (H.S. 4-digit) from Sri Lanka as per 2009-10  
(US\$ million) (contd)**

8418	Refrigerators, freezers & other refrigerating/freezing equipment, electric/other; ht pumps	0.46	0.51	0.58	6.65	25.1	22.99
0904	Pepper of the genus piper; dried or crushed or ground fruits of the genus capsicum or of the genus pimenta pepper **	6.12	10.06	14.31	18.87	15.78	16.15
4707	Recovered(waste & scrap) paper of paperboard	2.38	9.79	11.6	15.04	16.08	14.53
2710	Petroleum oils& oils obtained from bituminous mineral other than crude preparation nes;cntng70% or more by weight of these oils***			0.27	0.59	0.13	13.42
7010	Carboys, bolts, flasks, jars etc for conveyance or packing of goods; preserving jars of glass; stoppers, lids of glass	0	0.15	0.67	1.45	3.39	9.17

\*\* India mainly imports 09041120 which is light black pepper (neither crushed nor ground)

\*\*\* India has imported some amount of 271019 which is other motor spirits etc.

Source: Calculated from India Trades, CMIE

### 3. Positive and Negative Views on Trade Dynamics

An aggregate view of trade between India and Sri Lanka since the FTA came into force suggests a very positive picture with overall trade growing by many folds. Furthermore, the increased diversity and greater value addition in exports both from India and Sri Lanka is a positive development. It is also important to note that many products which experienced huge growth in trade are in the negative list of Sri Lanka. Sri Lankan experts observe that the main growth of exports from Sri Lanka has been due to copper products and vanaspati. Excluding these two products the export growth was much lower. Actually, Sri Lanka does not possess any distinct comparative advantage in these products. However, due to short-term tariff arbitration by Indian manufacturers investing in Sri Lanka helped exporters. The viability of the industry was only as long as there was a discrepancy between Indian & Sri Lankan tariffs on palm oil imports. In response

to the increase in global commodity prices in 2007/08, India cut import taxes on food imports including palm oil making vanaspati exports from Sri Lanka unviable. Accordingly, vanaspati exports in 2008 were US\$ 31.96 million, a reduction of 78% from exports in 2007 which amounted to US\$ 145.32 million. It is important to note that in 2009-10, vanaspati is no more in India's top 10 imports from Sri Lanka. India has also been concerned about the possible low value addition in copper products that was exported by Sri Lanka to India. Since, India insisted to link prices with London Metal Exchange Prices (LME), copper exports dropped significantly. Apart from this, experts also identified issues related to rules of Origin (RoO), tariff rate quota (TRQ), NTBs etc have created disadvantage for Sri Lankan exports.

Recent studies<sup>2</sup> highlight the fact that gains from trade must be studied from a general equilibrium perspective. Currently, India perhaps is replacing other countries in Sri Lankan market and its market share and investment share is thus increasing. At the same time, we also need to consider that the market size of Sri Lanka is growing as also Sri Lanka's overall trade. Sikdar (2010) shows that gains to Sri Lanka is much more than India under a free trade condition since India gain mainly from the relocation of resources and production base and Sri Lanka receives the benefit of free trade primarily. She further argues that the sector in which India or Sri Lanka have high endowment should be opened up as these countries have natural comparative advantage. In other sectors, technology will play an important role. If Tea, textiles, etc are subject to quota, India's gain comes down slightly but Sri Lanka's gain drops substantially. Similarly, in products like rubber, plastic etc Sri Lanka has positive endowment effect and India must receive the gain by removing them from negative list. In the model, if we allow technology to flow, the gain increases further. This implies, once we agree to a free trade agreement and allow FDI to come in with technology, production systems become further efficient reducing the relative price. However, this paper also identifies RoO, NTBs, poor port infrastructure,

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<sup>2</sup> Chandrima Sikdar (2010): India - Sri Lanka Bilateral Trade - A General Equilibrium Approach, forthcoming in South Asian Economic Journal, vol.11. No.2

cumbersome custom procedure etc. as the major area which are restricting the gains from trade.

#### **4. CEPA Negotiation and Trade in Goods**

In the goods sector, CEPA negotiation targeted to reduce negative list of both the countries so that India and Sri Lanka receive additional market access. Under ISLFTA, Sri Lanka had a larger negative list (1,180 tariff lines) than India (429 tariff lines). In post CEPA, India will reduce its negative lists by another 114 items while Sri Lanka would be reducing only 32 items. Altogether 3932 items have been reduced to zero customs duty for Indian exports by Sri Lanka out of a total of 5112 tariff lines. In return, India opened 4383 items (including 233 garment items) to zero duty. Only 196 items continued to attract normal customs duty for exports from Sri Lanka to India. Through CEPA, eventually Indian negative list will go down to 82 out of a total of 5112 items. India's concessions also include garment quota of 8 million pieces that was granted under the FTA. Besides the three million pieces granted at zero duty earlier, India has agreed to allow another three million pieces more at zero duty and the remaining two million at 75% margin of preference. Port entry restrictions and conditions of sourcing fabrics from India have also been removed.

This is important to note that under the SAARC process, India and Sri Lanka have entered into SAFTA Agreement. However, Sri Lanka has allowed openings of 1165 goods for Indian exporters under SAFTA framework. In this case, Sri Lanka had to accede to requests from other smaller South Asian countries. There are 139 items that do not figure in SAFTA negative list but are present in ISLFTA negative list effectively meaning that effective negative list of Sri Lanka as a result of SAFTA has been lower than ISLFTA. Indian exporters will tend to use SAFTA route (especially for those 139 goods) than ISLFTA route. This implies that Sri Lanka has been forced to open itself to Indian market more than under the bilateral format of ISLFTA. On the other hand, Sri Lanka has gained less from India whose negative list under SAFTA contains 865 items, much larger than under the ISLFTA and CEPA. Clearly, India affords greater concessions to Sri

Lanka in a bilateral format. On the contrary, in keeping with SAFTA agreement on trade in goods, India is likely to open much smaller number of sectors under SAFTA as against what it offered to Sri Lanka under CEPA in a bilateral format. This would mean that at the end of SAFTA India will have greater openings in Sri Lanka while Sri Lanka, having not entered into CEPA with India, will lose the larger openings offered by India in the latter. Hence, under the CEPA framework, Sri Lanka will enjoy better market access in India than SAFTA route.

Along with the effort of further liberalisation, CEPA seeks to address the "limitations" and "imperfections" of ISLFTA to facilitate smooth functioning of bilateral trade between India and Sri Lanka. It has attempted to remove the perceived impediments to exports. For example, to deal with the custom issues, CEPA provides for a close cooperation mechanism between the Customs Authorities. It aims to provide for new innovative means to facilitate swifter passage of consignments through the Customs. A proposed bilateral working group is expected to look into custom issues such as, 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 methods, adoption of advance ruling system etc. CEPA also seeks to address this problem through a framework Mutual Recognition Agreement (MRA) and adoption of common Sanitary and Phyto-sanitary standards that deal with barriers to trade. Sri Lanka will benefit in exportable products like ayurvedic products, fish and fishery products, coffee, tea and spices, edible fruits and nuts, vegetable fats and oils, all kinds of animal and animal products, plant and products of plant origin, etc. The CEPA also allows for sector specific MRAs in future to cover industry sectors. Currently, it is at the nascent stage and is not fully covered. Rules of Origin (RoO) were also a major bone of contention under ISLFTA as experienced by India and Sri Lanka. Under CEPA, it has been proposed to relax the RoO criteria of 346 products. Sri Lanka will be more competitive in Indian market due to this in sectors such as jewellery, machineries, furniture, electrical appliances, agri-processed items etc. More simplified guidelines have been given to ease the issuance of certificate of

origin for the goods entitled for CEPA. CEPA has also explored the possibility addressing the grievances through biannual meetings at the level of Commerce Secretaries and an annual meeting at the level of commerce ministers to deal with the complaints and pending issues. In case of continued problem, CEPA will make attempts for independent adjudication of disputes and provide for a separate dispute resolution mechanism that will stipulate in detail the rules and procedures for arbitration in case of disputes.

### **5. Services Trade between India and Sri Lanka**

The initial phase of the cooperation between India and Sri Lanka focused on trade in goods both in the context of SAFTA (South Asian Free Trade Agreement) 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 trans-shipment services as port of Colombo is a major hub port for India and tourism. India however focused in the export of both traditional services (construction, engineering, tourism) and knowledge based services (like software, education, health). Both the countries show much larger engagements in services trade in recent times. Increasing number of Sri Lankan students and patients travel to India to receive education & health services each year. Many Indian services companies such as VSNL, NIIT have already invested in India. Sri Lankan Airlines and Indian private airlines are now flying to each other's cities. Approximately 40% of Sri Lankan airlines' revenue is from the Indian market. IT firms in Sri Lanka are providing technical solutions to Indian companies. Sri Lankan has set up small hotels in different parts of India to cater to tourists coming to India.

The liberalisation of trade in services refers to the removal of barriers that obstruct trade across these modes. Unlike trade in goods where tariffs and taxes are the major trade barriers, government regulations comprise the major barriers to trade in services. These include limitations on foreign investment in services, limits on number of foreign workers permitted, restrictions on remittances of salaries and profits of foreign establishments and so on. The Indo-Lanka trade in

services agreement under the CEPA is expected to remove certain barriers in this direction. As the negotiation mainly went on the basis of positive list approach, it should have given flexibility to India and especially to Sri Lanka for commitment, considering the developmental priority. India has agreed to larger and deeper openings than Sri Lanka. India will open far more sectors upfront (about 80 sub-sectors) and grant deeper concessions in each of these areas. In return, Sri Lanka will take up more gradual approach, open only selected areas (about 20 sub-sectors), and restrict openings in these sectors upto the levels it is comfortable with.

India's overall commitments made during the negotiation have been very liberal in modes 1, 2 and 3. However, there are restrictions in Mode 4 with some extra market access commitments for Business Visitors (BV) and Intra-Corporate Transferee (ICT). BVs are permitted to stay 180 days and will not receive and remuneration in India and in case of Intra-Corporate Transferee (ICT), employee of a Juridical Person (JP) in Sri Lanka who is transferred to a JP in India owned or controlled by the JP in Sri Lanka is permitted to stay in India for a period maximum of 5 years for temporary provision of services. This is limited to managers, executives and specialists. Apart from this, India has also agreed to provide market access for a period of one year to Contractual Service Suppliers (CSS) and Independent Professionals (IP) in Engineering, Computer and Related Services, Hotels and Restaurant services, travel agency/tour operator services, Architecture, Integrated engineering services, Urban planning and landscape architecture, R&D services, Management consulting services, Services related to management consultancy, Tourist guide services, etc. Sri Lanka will get full market access to almost all sectors in modes 1, 2 and 3 (except in accounting which is limited to mode 1 and 2, architecture where mode 3 access requires a joint venture and R&D in agriculture which is limited to mode 1).

Sri Lanka's draft offers are somewhat limited and it is based on current round GATS with inclusion of few additional sectors. Sri Lanka has almost zero offers in mode 4. In other sectors, offers are also either at or below the current level of liberalization that is autonomously accorded through Sri Lanka's investment and

exchange laws<sup>3</sup>. In financial services, banking, Sri Lanka provides 100% foreign equity in Mode 3 conditional upon licensing, and in mode 4 foreign executives are allowed conditional upon extra capital investment. In computer and related services, Sri Lanka's draft offer allows access through modes 1, 2 and 3 but mode 4 is conditional upon capital investment and limited to expert trainers and high end technicians. In telecom, Sri Lanka's offers are the same as those reflected in the WTO with minor modification of flexibility to service provided. In health services it has made an offer in telemedicine through mode 1 on a doctor-doctor basis for purposes of a 2nd opinion not the doctor – patient contact. In mode 3 in health services market access is liberalised outside the Western Province. There are no commitments in mode 4 in health services. Sri Lanka has also offered to open mode 3 through commercial presence with 40% foreign equity in case of passenger transportation and freight forwarding. In maintenance and repair of sea-going vessels, Sri Lanka has agreed to open through Mode 4, in which the import of certain skill categories from India including naval architects, skilled welders and fitters, project/ship repair managers, repair engineers and automation engineers are allowed. However, any Indian labour entering through this agreement will need to obtain a temporary employment contract with a Sri Lankan employer and will be subject to all relevant immigration laws and work permits. Hence, CEPA proposals ensure conditional entry of Indian professionals only in few sectors in Sri Lanka (Financial services, Computer and related services and Ship repair and building) in contrast to the popular belief that Indians will flood the Sri Lankan market.

It is expected that the agreement in services are going to be beneficial for both the countries. Sri Lanka will not only be able to access Indian market but also will be able to source investment and skilled labour to fill up the gap in its own country in several sectors. For India, the agreement assures suitable investment in Sri Lanka<sup>4</sup>.

<sup>3</sup> Deshal De Mel (2008): India Sri Lanka Comprehensive Economic Agreement; ITC World Trade Business Briefing; 15<sup>th</sup> October.

<sup>4</sup> Biswajit Nag (2006): A Review of India-Sri Lanka Trade Cooperation: IIFT Occasional Paper, No. 24; <http://cc.iift.ac.in/research/research.asp?menuid=14>

## 6. Issues in Investment

Indian investment into Sri Lanka has increased significantly since the FTA came into operation, major reason being the ability to re-export to India while benefiting from lower tariffs on raw materials in Sri Lanka. Between 1978 and 1995, Indian investment accounted for only 1.2% of total FDI. Cumulative Indian investment which was a mere US\$ 1.44 million in 1998 increased to US\$ 126 million by 2008, contributing to 14% of total FDI flows to Sri Lanka and securing the position of second biggest investor (exceeded by Malaysia). Some of the most visible Indian investments are Lanka Indian Oil Corporation, TATAs (Taj Hotels) VSNL, Watawala tea plantations, LIC, L&T (now Aditya Birla Group), Ambujas, Jet Airways, Bharti Airtel etc.<sup>5</sup> Indian Human Resource and education companies like ICFAI, banks like ICICI have also entered in Sri Lankan market. Axis Bank, Bank of Baroda etc. are also looking at the opportunity in Sri Lanka. Almost 63% of Indian investment is in the sectors such as telecommunication, health, retail service, energy, hospitality and aviation sector. By the end of 2007, Indian investment resulted in close to 100 projects, employing 6747 individuals<sup>6</sup>. Kelegama identifies that during the FTA period job creation by Indian investment has been limited<sup>7</sup>. FTA has been mainly concentrated on goods sector and perhaps CEPA can address the issue related to investment in much better way. Beyond service sector much of the investment in Sri Lanka especially in the manufacturing sector came from India & third parties in sectors such as vanaspati and copper. This has been to export products back to India and some other countries. CEPA proposes that the Investment Agreement will provide an institutional framework to create an enabling environment for greater flow of investments between the two countries. There will be an MRA on standards. This Agreement on Mutual Recognition/equivalence will facilitate recognition of each other's standards, assessment procedures, equivalence arrangements etc. It also

<sup>5</sup> N. Taneja; A. Mukherjee; S. Jayanett; T. Jayawardane: 'Indo -Sri Lanka Trade In Services: FTA II and Beyond' ; Indian Council for Research on International Economic Relations (ICRIER) ,2004.

<sup>6</sup> S. Kelegama (2009): India-Sri Lanka Bilateral Free Trade Agreement: Sri Lankan Perspective and Implications; Presentation to the 'Asian Regional Workshop on Free Trade Agreements: Towards Inclusive Trade Policies in Post-Crisis Asia', jointly organized by IDEAS, GSEI, & ITD, Bangkok, 8-9 December available through [networkideas.org/ideasact/dec09/ppt/Saman\\_Kelegama.ppt](http://networkideas.org/ideasact/dec09/ppt/Saman_Kelegama.ppt)

<sup>7</sup> Ibid.

proposes for an MOU on Harmonisation of Ayurvedic medicines which is expected to enable both countries to cooperate in traditional system of medicines. Several studies identifies that Indian investment in Sri Lanka helps domestic entrepreneurs to develop JVs with Indian players for exploring market access possibility in other countries through efficient production system and exploiting economies of scale.

## **7. Epilogue**

### *7.1. Concerns for domestic market*

Negotiations of the CEPA began in 2005, and were completed in three years. The CEPA Agreement framework was scheduled to be signed in July 2008. But due to reservations expressed by local industrialists as well as a political party in Sri Lanka, the CEPA was not signed. It has gone into uncertainty since then. Reservations were based on 2 broad concerns: about the nature of the CEPA itself and that the drawbacks in the FTA should be dealt with first, prior to embarking on a CEPA. It is important to note that CEPA has made attempts to address both the issues. Sri Lanka's negative list is much bigger than India and its offer in service sector is also quite restrictive and scope for Indian personnel working in Sri Lanka in large scale is really limited. Hence, CEPA has taken care of the economic asymmetry between these two countries. Also, several concerns on FTAs have been addressed while negotiating CEPA for three years. Issues related to custom clearance, transparency, relaxation and simplification of RoO, simpler guideline for issuance of certificate of origin, standardization SPS, dispute settlement etc. have been discussed during the negotiation and definite steps have been proposed in CEPA. Actually, the CEPA was negotiated with the very objective of addressing the shortcomings in the FTA and it also provides a proper platform to put up the grievances to the highest authority in both the countries. Hence, as an agreement, CEPA covers all aspects of concerns as highlighted by local industrialists in Sri Lanka.

## 7.2. Opportunity in Indian market

It has been mentioned in the article that if CEPA is not implemented Sri Lanka will continue to have limited market access in India through agreements like ISLFTA, SAFTA and APTA. Meanwhile, India has opened markets to other countries (such as ASEAN members, Korea Rep. etc) and is actively engaged in negotiation with some other countries (such as EU, Japan) also. Delaying implementation of CEPA implies Sri Lanka's lost opportunity in Indian market. In the absence of progress in regional frameworks such as SAFTA, and slowing down of WTO discussion, the best option available to Sri Lanka is a bilateral framework within a rule-based disciplinary structure. Through CEPA, India provides a guaranteed access to Indian market which is identified as one of the fastest growing emerging economies. Sri Lanka's own domestic market is small and entrepreneurs will never be able to achieve economies of scale unless it is integrated with bigger markets. India provides that opportunity being a neighbouring country. Whether there is CEPA or not, trade between these two nations is bound to increase and CEPA will provide an extra advantage to Sri Lankan businessmen.

Sri Lanka has very concentrated export basket. ISLFTA has provided an opportunity to diversify its exports. As Indian economy is growing fast, wages and other cost of production are bound to increase. Sri Lankan goods in medium term will find their ways in Indian market. Several production bases will shift to Sri Lanka for exporting back to India. In this context we can refer the outsourcing of manufacturing goods in USA from small Caribbean islands. CEPA will perhaps lead similar kind of integration between India and Sri Lanka through 'production network' both in manufacturing and services sectors.

According to Kelegama<sup>8</sup> Sri Lanka's export destinations are primarily developed countries which are in vulnerable conditions due to prolonged recession. Hence, Sri Lanka must capture the opportunities available in big countries such as India and China which are having high growth even during the time of recession. The

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<sup>8</sup> Ibid

ISLFTA has somewhat helped in shifting Sri Lanka's trade towards alternative emerging markets by encouraging exporters to move beyond their traditional buyers. Given Sri Lanka's proximity and long-standing relationship with India, the country is in an ideal position to take advantage in the shift in global economic powers towards the East. The CEPA should be seen as an attempt to manage Sri Lanka's trading relationship with India. The Agreement provides a legal framework which defines the rules and regulations under which trade occurs between the two countries.

According to Senanayake<sup>9</sup> economic literature describes that small countries tend to gain when they get access to big country markets mainly on two counts. They will be able to derive benefits of economies of scale as their own market size is small and they will be able to take advantage of the relative price differential. Investment liberalization through CEPA will help Sri Lanka to get FDI and technology for setting up modern plants, factories and service providing offices. The output will definitely cross the border as size of the domestic economy is small. Hence, CEPA will play the role of a catalyst in diversifying Sri Lanka's export basket eventually.

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