ECONOMIC REVIEW
July/August:2003

International Trade & Development

A People's Bank Publication

Diary of Events

July

4th The cabinet has approved Asia Capital consortium (consisting of John Keels, Carsons Cumber Batch and Ceylon Biscuits) as the successful bidder for the Rs.680 million CWE Privatization deal. The privatization Process is to be completed during this month.

An Agreement for a US$ 5 million line of credit was signed between the OPEC Fund for International Development and Lanka Orix Leasing Company Ltd. of Sri Lanka.

9th The Asian Development Bank (ADB) has approved a technical Assistance grant for US$ 150,000 to help Sri Lanka prepare a master plan for its port sector to guide policy formulation and infrastructure investment

17th The first Five Star Plus Hotel with a Rs.650 million investment is to be constructed in Goyanbokka, Tangalle in two stages. The 50% of the total investment for the hotel is to be provided by Singapore while the remaining 50% will be funded by Sri Lankan Banks.

19th The Government has decided to opens up rural economic centers with modern facilities in permanent buildings in order to collect and market agricultural products in the rural areas. The upcountry rural Reconstruction Department and the Japanese Bi-Lateral Development Trust are jointly funding this project.

23rd A special Economic Centre catering to the residents of Moratuwa , Ratmalana, Mount Lavinia, Dehiwala and the surrounding areas providing basic essentials at affordable prices is to be set up at Golumadama Junction, Ratmalana.

29th India has agreed to sign a Memorandum of understanding (MoU) with Sri Lanka to recognise bilateral export inspection schemes and to liberalise the business visa application procedure at the recently concluded second senior officials meeting under the Indo-Sri Lanka FTA in New Delhi. The officials also agreed to grant three more entry points for Sri Lanka's Tea and readymade garments , with provisions to expand the tariff concessions granted for textiles.

30th The US government has awarded a $ 560,000 grant to the Government of Sri Lanka to fund a technical assistance programme for providing consultancy services on the development of a 300 MW coal fired power plant. The award was announced by US Trade and development Agency.

August

2nd South Korea will provide a grant of US$ 17.6 million for Balangoda – Bandarawela Road Rehabilitation project. With the implementation of this project, a 57 km road section from Balangoda to Bandarawela will be improved along with selected bridges and pavements. Road side drainage will also be constructed.

4th Gulf Air has increased operations from five flights a week to a daily direct operations between Colombo and Abudabi from July 01.Gulf Air currently operate a fleet of 36 air craft to 43 cities in 32 countries worldwide. Gulf Traveller has a total fleet strength of six aircraft.

Work on the 4.8 million-rupee Building Complex for the Hotel School in Kuruwita commenced at a location close to the Pussalla Rural Development Training Centre. Over 300 trained persons have joined the hotel industry from this school from its inception.

The Government of Japan has decided to provide a grant of 250 million rupees (approximately US dollars 2.6 million) to improve material and child health services in the war affected districts in the North and East and three neighbouring districts Anuradhapura, Moneragala and Puttalam.

5th Japan has decided to provide a grant of 250 million rupees (approximately US$ 2.6 million) to improve maternal and child health services in the war-affected districts of the North and East and three neighbouring districts Anuradhapura, Monaragala, and Puttalam. This emergency grant will be channeled through the United Nations Children's Fund-(UNICEF) in Colombo.

13th The Chinese government has agreed to provide Sri Lanka a grant of Rs.400 million for the development of the economy and the technical spheres of Sri Lanka, under the provisions of concessionary loan signed between the two governments. In addition to this grant China will also provide Rs.2400 million to Sri Lanka as a provision and concessionary loan.

14th Arrangements have been made to develop the Welimada town at a cost of Rs 192 million under this project, trade stalls will be built at a cost of Rs 15 million for the use of pavement hawkers. Another Rs 79 million will be spent to build a new Super Market with large shops for the traders. One of the significant features of this project is providing ample access facilities for the disabled persons.

15th Lion Air International has invested US$ 300,000 and signed an agreement with a South African Airline Company to lease a Mc Donnel Douglas DC-9 jet aircraft.

The Government has appointed Housing Development Finance Corporation Bank (HDFC Bank), the apex body for supervision and monitoring of a further sum of rupees 200 million allocated to other state and private banks.

16th Shell gas has increased the price of its 12.5 kg. domestic LPG cylinder by Rs 25. Accordingly, the new selling price of a 12.5 kg domestic cylinder will be Rs 595 (Colombo basis)

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SPECIAL REPORT

INTERNATIONAL TRADE & DEVELOPMENT

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International Trade

Present Status and Future Directions

Rupa Dheerasinghe

Senior Economist/Head, Trade & Coomodity, Study Division, Central Bank of Sri Lanka.

At independence Sri Lanka inherited a classic open economy with dualistic features - a modern plantation sector and a subsistence agriculture sector. For the next three decades, trade policy bounced back and forth between closed, inward looking policies and open economic policies. From 1977 till today Sri Lanka has gradually been opening up its economy. Over the past fifty five years the composition of exports changed from domination by the agricultural sector to domination by the industrial sector. In imports, intermediate goods became more important than consumer goods. However, thecomposition of exports has not changed much during the last ten years and is concentrated in two major products. Export markets too are concentrated in a few large economies in the West. Origins of imports are relatively diversified, but more concentrated in the Asian region.

Sri Lanka, which remained an exporter of primary products for nearly three decades after independence, experienced significant changes after the economic liberalisation in 1977. Subsequent to the initial phase of reforms, trade reforms were instituted in the late 1980s and in the 1990s. Export duties were withdrawn by 1992 except on a few items. Quantitative controls on exports and imports were totally eliminated, with the exception of a few items that were kept under licensing for non-economic reasons. Sri Lanka's exports grew by 8.3 per cent annually during the period 1978-2002. Thus, Sri Lanka was able to attain a market share of 0.08 per cent of total world exports by 2002. Sri Lanka's imports grew annually by 10.3 per cent during the last two and half decades. International trade became a dynamic force in the economy, assisting in the growth of income and employment opportunities. However, during the last 5 years, both export and import sectors grew at a slower rate than in the previous two decades. Since liberalization, the export structure has become diversified with industrial exports, led by textiles and garments, becoming the largest contributor to export earnings, accounting for 77 per cent of total exports in 2002. The composition of imports also changed significantly from consumer goods to growth oriented intermediate and investment goods. Imports and exports in 2002 accounted to 65 per cent of GDP compared with 35 per cent in 1977 and 71 per cent in 1990.

World Outlook

During the first decade after liberalisation, Sri Lanka's exports grew at a slower rate than world exports **(Table 1)**. The growth of exports was slower than in Asian and non-oil exporting countries as well. However, Sri Lanka's imports increased at much faster rate. During the second decade, i.e. 1988-1997, Sri Lanka's exports and imports grew at a faster rate than world export growth. However, during 1998-2002 both Sri Lanka's exports and world exports grew at a slower rate than in previous periods. During this period Sri Lanka's export growth rate was lower than that of the world, non-oil developing countries and Asian countries.

The degree of openness (trade dependency) increased gradually after economic liberalisation but declined during the last three years **(Table 2)**. Sri Lanka's total external trade as a percentage of GDP was 77.5 per cent in 2000 compared to 34.7 per cent in 1977. This declined to 65.3 per cent in 2002. However, Sri Lanka's share of the world export market increased marginally from 0.07 per cent in 1977 to 0.08 per cent in 2002.

Table 1	Growth Rates							
	Export Growth (%)				Import Growth(%)			
	78-02	78-87	88-97	98-02	78-02	78-87	88-97	98-02
World [1]	8.8	8.9	11.7	2.8	7.6	8.9	8.6	3.1
Non-Oil Developing Countries	12.2	14.5	13.5	4.7	12.0	13.9	14.5	3.2
Asian Countries	9.9	11.6	11.0	4.3	9.3	9.9	12.0	2.6
Sri Lanka	8.3	7.2	13.1	0.8	10.3	13.6	11.2	1.6

[1] World imports and exports may not tally as they are recorded in c.i.f and f.o.b values, respectively.

Sources: IFS Data Base and Central bank of Sri Lanka

Domestic Trade and Tariff Policy

Soon after the independence, the economy of Sri Lanka benefited from very high prices for rubber and tea resulting from the Korean war boom. The balance of payments was in surplus and restrictions were somewhat relaxed on foreign trade and payments. However, a regime of import substitution began to emerge with the balance of payment problems experienced in the late 1950s with the sharp drop in commodity prices in the world market. The unrestricted trade regime in place was changed drastically with the introduction of restrictive policies and practices. The Government resorted to protectionist measures such as exchange and import controls. The restrictive measures became more stringent with the introduction of import quotas and licences. Import tariffs too were gradually increased and the coverage expanded, as more items of imports were brought under tariff control. A highly differential import tariff structure came into being with rates varying from 10 per cent to 500 per cent. The economy during 1960-1977 was characterised by inward looking policies even though the 1965-1970 period saw an effort to implement a partial trade liberalisation. The period 1970-1977 saw the most stringent trade restrictions ever to be introduced in Sri Lanka.

The development strategy hitherto pursued under the import substitution policy was shifted to an export promotion policy with the changes introduced after 1977. As a result, export industries were supported with generous incentives in the forms of tax concessions, credit at low rates of interest, infra-structure facilities and institutional support. During the early export promotion phase, steps were taken to encourage foreign investment. Institutions and policy reforms were implemented to facilitate more private sector participation in economic activities. Export licensing requirements and export duties were removed gradually, while export duties on all minor agricultural commodities and marine products were abolished in 1988 and duties on traditional export crops, i.e. tea, rubber, coconut, were removed in 1992. Only a few categories of exports, namely wood and article of wood (ebony), ivory and ivory prod-

Table 2 Trade Dependency Ratios

Item	1977	1987	1997	2002
Exports as a % of GDP	16.3	20.0	30.5	28.4
Imports as a % of GDP	16.5	30.8	38.8	36.9
Exports as a % of World Exports	0.07	0.06	0.09	0.06
Imports as a % of World Imports	0.07	0.06	0.10	0.06

Sources: Central Bank of Sri Lanka, IFS Data Base

ucts, some mineral products and passenger motor vehicles that registered in Sri Lanka prior to 1945 continued to remain under licence, with the objective of environmental protection and preservation of antiques.

Trade liberalisation was a vital part of the open economy policies that were put in place in 1977. Under these policy reforms, the stringent controls that were in force on imports were removed gradually. Exchange controls were relaxed gradually and by 1994 all such controls on current account transactions were removed. As a part of the open economy policy the multiple exchange rates in force were unified in 1977 and the exchange rate regime became a managed float. The next fundamental change with respect to the exchange rate regime was taken on 23 January 2001, by moving to an independent float. The exchange rate is now determined by market demand and supply conditions with occasional interventions by the Central Bank to build up reserves and to minimize excessive fluctuations in the exchange rate.

Most of the controls on imports and prices were removed, while the tariff structure was rationalised and simplified. The public sector monopoly on imports was reduced gradually and by 2001 such commodities were limited to crude oil and defence related items that were kept under state control. Quantitative restrictions on imports were eliminated. Although a few such measures were retained for health protection purposes, and most of the licensing requirements after 1977 were for strategic and security purposes. A total of 300 items at 6 the digit level of Harmonised System Code (HSC) remained under import controls by the end of 2002.

A major tariff reform took place in 1990 with the implementation of the recommendations of the Presidential Tariff Commission Report - 1990. The tariff structure, which had rates ranging from 10 percent to 500 percent and more than 15 major tariff bands prior to 1977, was reduced to 3 bands in 1990 and to 4 bands in 1991. A three band tariff structure with 10, 20 and 35 percent bands was introduced in 1995 and was further simplified to a two band system with 10 and 25 percent bands in 2000. A few items of imports remained outside the two band system. By mid 2002, import duty on selected agricultural products such as green gram, cowpea etc. remained at 35 percent as a temporary measure to allow the domestic agricultural sector to adjust to a lower tariff regime over the medium term. The items considered as essential for the maintenance minimum living standards are taxed at zero tariff. A further number of items, mainly petroleum, sugar, tobacco, liquor and plastic, were brought under specific rates outside the two-band system.

The simplicity of the tariff structure was disturbed by the introduction of surcharges and grant of duty waivers on certain products in 2001. A 40 percent surcharge on import duty under Section 10(A) of the Customs Ordinance was imposed on 21 February 2001. Imports with zero duty (such as pharmaceuticals, fertiliser, tractors, lorries etc.) were automatically exempted from this surcharge while a number of essential products such as potatoes, edible oil, sugar, infant milk food, infant food and selected items of milk and cream products, coconut oil and copra were also exempted from the surcharge in view of cost of living considerations. The entire range of textiles and garment items (Chapter 50-63) was also exempted from this additional surcharge. The surcharge was reduced to 20 percent with effect from 15 April 2002.

The tariff regime became more complex with the introduction of new tariff bands between 2 and 20 percent in November 2002. Items in the zero percent bands were brought under the 2 percent and 10 percent bands, with the majority of items being placed under 2 percent band, except for those of textiles and wheat. Textiles and wheat remained duty free while some petroleum products which were under the 10 percent or 25 percent bands were made duty free. Duty rates on a few items were increased from 10 percent to 20 percent or from 5 percent to 10 percent. However, distortions to the tariff regime by way of duty waivers, exemptions and surcharges were maintained at a minimum level. A Tariff Advisory Council was set up in 2002 to examine and correct anomalies and distortions in the tariff structure and to address representations made by importers and industrialists.

Growth Performance

Sri Lanka's exports in US dollar terms grew by 8.3 percent while imports grew by 10.3 percent annually during the period 1978-2002. The export sector showed fairly steady growth during the first two decades after liberalisation and became a dynamic force in the economy, assisting in the growth of income and employment opportunities. The export sector grew by about 6.7 percent during the first five years after liberalisation. Imports increased at a much faster rate during the first five years of liberalisation due to the high demand for consumer products that emerged immediately after liberalisation and rapid increase in investment and intermediate goods imports. However, the high oil bill resulting from second oil price shock and the associated world recession adversely influenced exports during 1979 and 1980, resulting in a large trade deficit. Subsequent increases in commodity prices too contributed to the growing imports during this period (Chart 1).

During 1983-1984 Sri Lanka benefited from favourable tea prices but export growth was negative in the following two years. The export sector recovered again in 1987. However, expenditure on imports rose at a much slower rate during 1983-1987 due to sluggish economic growth attributable to escalation of civil disturbances.

Chart 1: Growth Rates: Five Year Annual Averages

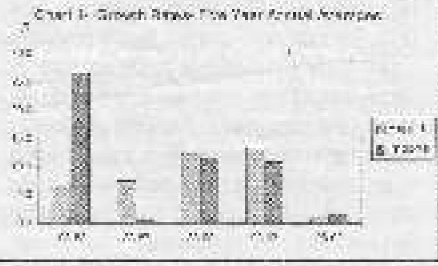


Chart 2: Trends in Growth Rates

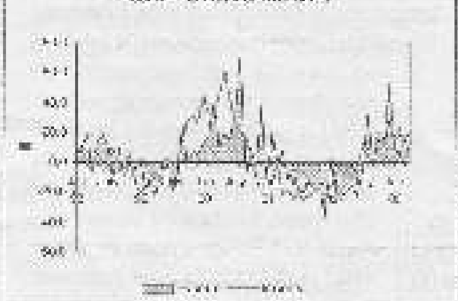
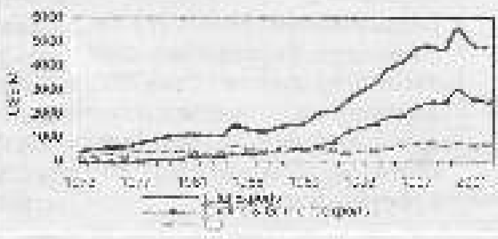


Chart 3 Export Earnings - Textile & Garments & Tea



Both exports and imports recorded higher growth rates during the second decade after liberalistion. Export earnings increased by 13 per cent, while imports grew by 11 per cent during this period. Export growth was driven by significant growth in garment exports. A high growth in imports reflected a higher level of intermediate and investment goods as well as increased direct private capital inflows. High defence expenditure too contributed to this high growth in imports. Though exports increased at a higher rate than imports, import expenditure was higher than exports earnings in absolute terms, resulting in continuing deficits in the trade account.

Table 3 Sri Lanka's Balance of Trade (US$ Mn.)

Item	1977	1987	1997	1998	1999	2000	2001	2002
Exports	751	1,397	4,648	4,798	4,610	5,522	4,817	4,699
Imports	677	2,056	5,864	5,890	5,980	7,320	5,974	6,105
Balance of Trade	74	-657	-1,216	-1,092	-1,370	-1,798	-1,157	-1,406

Source: Central Bank of Sri Lanka

During 1998-2002, Sri Lanka's imports increased at much slower annual average growth rate of 1.6 per cent while exports increased only by 0.8 per cent. This slowdown in external trade during the last five years was largely attributable to weak performances in 1999, 2001 and 2002. The recent trends clearly indicate positive relation between exports and imports. As more than 75 per cent of imports were in the form of intermediate and investment goods, exports follow the trend in imports with 4-6 weeks lag (**Chart 2**).

The recent slowdown in both exports and imports was due to a number of factors, both domestic local and international.. Following the 13.3 per cent growth in exports and 7.7 per cent growth in imports in 1997, both exports and imports slowed down during the second half of 1998 and recorded lower growth rates of 3.4 per cent and 0.4 per cent, respectively, in 1998. This trend continued until the third quarter of 1999, resulting in a 4 per cent decline in exports in 1999 compared to the already low growth in 1998. Imports declined by 5 per cent in 1999[1]. This decline was associated with the lower aggregate global demand and increased competition from East Asian countries for industrial products. Meanwhile, tea exports suffered due to world production surpluses and the Russian currency crisis that began in mid August 1998. However, during the last quarter of 1999, both exports and imports showed signs of recovery. This was attributable to robust economic growth in USA and the European countries. The recovery in the East Asian countries from the currency crisis and the appreciation of their currencies improved Sri Lanka's competitiveness in rubber based products and garments. Tea prices also showed a recovery in the last two months of 1999 due to lower production in major tea producing countries and high demand from the Commonwealth of Independent States (CIS) in the Colombo market.The positive trend continued through out 2000 leading to a high growth rate of 19.8 per cent in 2000. Imports too followed the same trend, achieving a 23,6 per cent growth in 2000.

Exports began to decline after May 2001 following the economic slowdown in major export markets, particularly, USA and the European Union (EU). The sharp weakening in the US economy, slower growth in the EU a fragile economy in Japan, a significant slowdown in newly industrialized Asian economies and ASEAN –4[2] together contributed to the slower growth in trade. The drop in demand in these countries, particularly in major export markets for developing countries, including Sri Lanka, had adverse repercussions on foreign trade in 2001 and the early part of 2002. Two terrorist attacks that took place at the Katunayaka International Airport in Sri Lanka on 24 July 2001 and in the USA on 11 September 2001 too had serious impact on international trade in Sri Lanka during this period. Import expenditure declined continuously till May 2002, and then showed a recovery thereafter. Exports too showed a recovery after August 2002. Eventhough uncertainty prevailed in the Middle East and disruptions to oil production in Venezuela raised oil prices and reduced the demand for developing country exports in general, Sri Lanka benefited from the recovery in the global economy, the peace initiative commenced by the government in early 2002 and macro economic adjustments undertaken during this period. The positive trends in both imports and exports continued during the second half of 2002.

Table 4
Sri Lanka's Terms of Trade Performance

(1997=100)

Year	Export Price Index	Import Price Index	Terms of Trade (a)
1996	91.5	97.7	93.6
1997	100	100	100
1998	114.9	101.3	113.4
1999	114.6	106.4	107.7
2000	125.2	123.8	101.1
2001	139.6	139.9	99.8
2002	143.1	138.2	103.5

Sources: Central Bank of Sri Lanka

(a) Export Unit Value Index/Import Unit Value Index)* 100

Balance of Trade

The balance of trade is the difference between the value of merchandise exports and imports. As the outlays on imports were in excess of export earnings, this has been in deficit for nearly two and a half decades after 1977. The trade account registered surpluses (in US dollar terms only once in 1977), during the tea boom in 1976 and 1977. This deficit, which exceeded US dollars 1,550 in 1994, narrowed down gradually during 1995-1998 due to relatively lower growth in imports than in exports. However, it reached its highest level in 2000, but has remained lower than US dollars 1,500 in recent years.

Terms of Trade

Terms of trade is a measure of relative movement of export and import prices. There is no uniform series of trade indices available in Sri Lanka for a long period as several base years have been used for different series. The methodologies used for constructing these different series of indices have also been different. According to the most recent series of trade indices published by the Central Bank, Sri Lanka's terms of trade have been favourable during the period 1997-2002, except 2001, i.e. prices of Sri Lanka's exports have increased at a faster rate than the prices of imports.

Fluctuations in the export price index were closely linked with the price movements in the prices of garments and tea, while the import price index moved with petroleum, fertiliser, textiles, wheat, rice and sugar.

Structural Changes

Exports

Following the introduction of liberalisation policies in 1977, the export structure of the economy changed drastically from an agricultural base to an industrial base by 1995, but no significant change has been seen thereafter. Industrial exports have become more significant since the early 1980's and as a result, the share of agricultural exports declined from 79 per cent in 1977 to 20 per cent in 2002 (**Table 5**). Industrial exports are the major contributor to exports, its share increasing from 14 per cent in 1977 to 77 per cent in 2002. This ratio has remained around 75 per cent during the last 10 years. Textiles and garments, which became the Sri Lanka's largest single item of exports in 1986, continues to maintain its position, increasing its share from 29 percent in 1990 to 52 percent in 2002 (Chart 3). Although the gross earnings from the textile and garment sector are high, tea remained the country's largest net foreign exchange earner till 1991. The textile and garment sector has become Sri Lanka's largest net foreign exchange earner since 1992 (Chart 4), partly attributable to a shift from low value added garments to high value added garments and the rapid expansion of the sector as a whole.

The total value of export earnings in this sector was at US dollars 2,424 million accounting for 52 percent of the total export earnings in 2002. The contribution to the Gross Domestic Product (GDP) from this industry was 6.0 percent in 2002. This industry provides more than 330,000 direct employment opportunities or 5 percent of the country's total employment through more than 1,000 garment factories.

Sri Lanka's textile and garment exports have concentrated on a few export markets. The USA accounted for 63 percent of the total garment exports while the share of the EU was 31 percent in 2002. Canada accounted for 2 percent of total garment exports. More than ninety countries, including Australia, Japan, Switzerland and Israel accounted for the balance 4 percent. Even though the USA and the EU accounted for more than 94 percent of Sri Lanka's garment exports, Sri Lanka accounts for only 2.3 percent and 0.9 percent of the USA and EU garment markets respectively.

The composition of the textile and garment exports has shown only a marginal change over the past 2 decades. Garment exports accounted for more than 96 percent of total textile and garment export in 1990. Textiles, other made up articles and yarn emerged as export items in the early 1990s and increased their shares to 5 percent each, while garment exports accounted for more than 90 percent of total textile and garment exports in 2002. Sri Lanka expanded its product coverage from four items (shirts, trousers, blouses and jackets) in 1977 to a broad base of more than 50 items in 2003 but still highly concentrated in a few product categories, particularly casual wear for men and women. The quota restrictions imposed by the major importing countries limited most of these popular items.

Several industrial sectors showed a significant improvement in the last decade, further diversifying the export composition and hence strengthening the resilience in the economy. These were machinery, mechanical and electrical appliances including spare parts and electronics, diamonds, rubber based products, crustaceans and molluscs, leather products such as footwear and travel goods, jewellery, petroleum products, canned food, fruits and fish products, chemical products and handicrafts. Exports of mineral products dominated by gems also improved after 1977. The contribution by all these products taken together, increased from 22 percent in 1977 to 28 percent in 2002 surpassing the relative position held by plantation sector products.

During the last five years, large number of new products such as dried prawns, meat, soya based products, jaggery, sweet meats, wall tiles, statues, printing and writing papers, packing materials, printed [illegible] textiles, parts and accessories of [illegible]

Table 5 - Composition of Exports

Category	Exports (US$ Mn.) 1977	1987	1997	2002	Percentage Share (%) 1977	1987	1997	2002
1. Agricultural exports	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Tea	[illegible]	[illegible]	718.0	670.0	[illegible]	[illegible]	[illegible]	[illegible]
Rubber	[illegible]	[illegible]	79.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Coconut	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	2.0	[illegible]
Kernel products	[illegible]	[illegible]	[illegible]	41.0		[illegible]	[illegible]	[illegible]
Other	[illegible]	[illegible]	25.0	42.0		[illegible]	0.9	[illegible]
Minor agric. food products	21.0	33.0	143.0	165.0	3.3	4.2	3.1	[illegible]
2. Industrial exports	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Food beverages and tobacco			91.0	[illegible]	[illegible]	[illegible]	2.0	[illegible]
Textiles and garments	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Petroleum products	67.3	86.0	97.0	75.0	[illegible]	[illegible]	2.1	[illegible]
Rubber products			[illegible]	[illegible]	[illegible]	[illegible]	3.5	3.8
Ceramic products			53.0	43.0	0.0	0.0	1.2	0.9
Leather, travel goods and footwear			[illegible]	[illegible]	0.0	0.0	[illegible]	[illegible]
Machinery and equipment			204.0	209.0	0.0	0.0	4.4	4.4
Diamond and jewellery			142.0	[illegible]	0.0	0.0	[illegible]	[illegible]
Other industrial exports		[illegible]	[illegible]	[illegible]	0.0	1.0	[illegible]	[illegible]
3. Mineral exports	[illegible]	[illegible]	90.0	90.0	4.0	[illegible]	[illegible]	[illegible]
Gems	29	49.0	84.0	88.0	4.4	[illegible]	[illegible]	[illegible]
Other mineral exports	2.6	11.0	6.0	5.0	[illegible]	[illegible]	[illegible]	[illegible]
4. Unclassified	[illegible]	[illegible]	[illegible]	41.0	4.7	4.7	[illegible]	[illegible]
Total exports	715.2	1087.0	4639.0	4700.0	100.0	100.0	100.0	100.0

Source: Central Bank of Sri Lanka

Table 6 Country-wise Classification of Garment Exports

Country	Percentage Share 1990	1995	2002	Average growth 1997-2002
USA	63.3	80.7	63.0	6.0
EU	27.0	34.2	31.0	3.6
O/w: UK	6.2	13.7	19.0	12.2
Germany	9.0	9.0	3.4	-8.7
Netherlands	3.4	3.6	1.5	7.0
Canada	2.2	1.7	1.9	13.4
Other Countries	4.5	3.4	2.0	6.7
O/w: Australia	0.2	0.3	0.7	13.1
Japan	.3	0.7	0.6	4.5

Source: Central Bank of Sri Lanka

Chart 4
Net Earnings from Textile & Garments vs Tea

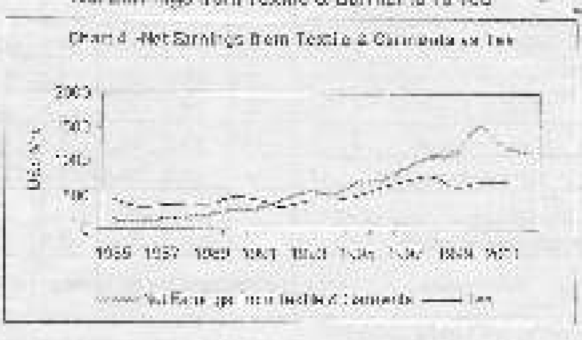


Table 7

Structure of Textile and Garment Exports

(Percentage Share)

Product	1990	1995	2002
Textiles	0.4	2.8	2.6
Garments	96.5	86.9	92.8
Yarn	...	2.4	1.?
Made up articles	2.1	5.5	1.8
Other	1.0	2.0	1.0
Total	100	100.0	100

Source: Central Bank of Sri Lanka

of mechanical equipment, aircraft and aircraft parts, static converters, primary cells, cordless telephone sets, turbo propellers, various glass products, articles of iron, copper, steel, stainless steel, aluminium and nickel, parts of clocks and cameras, bathing caps, hand and umbrellas, pencils, crayon paint or artists brushes and various chemical products were exported to various destinations.

Although the relative contribution of agricultural exports has declined over the years, diversification of products from traditional crops to other agricultural products has been evident in the recent past. Within the agricultural product category non-plantation agricultural products, dominated by cinnamon, unmanufactured tobacco and pepper, took the place of rubber as the second. Export earnings from agricultural products declined by 2 per cent during last 5 years.

Tea, the largest plantation commodity contributed 70 per cent to total agricultural product exports. Earnings from tea declined by about 1 per cent during the last 5 years. Out of Sri Lanka's total tea exports, 64 per cent was in bulk form, while 29 per cent was in packet form. The rest was in higher value added forms such as tea bags, tea blended with fruit flavours, instant and green teas. Orthodox tea accounts for more than 99 per cent of Sri Lankan tea export, while Cut, Tear and Curl (CTC) tea was produced in small quantities. Sri Lanka imported 9 million kg of tea for blending purposes, which was only 4 per cent of the domestic production in 2002. The tea industry should be forward looking and produce more value added forms of tea and find new markets away from conventional markets. Russia continued to be the largest buyer (19 per cent) in 2002. UAE became the second largest buyer (11 per cent), while Syria (10 per cent) continued to hold the third position. Other major buyers were Iraq, Turkey (5 per cent each), Iran (4 per cent), Jordan and Saudi Arabia (3 per cent each). However as a group, the Middle East countries were on top accounting for 44 per cent of total tea exports while the CIS countries were second (25 per cent) followed by the EU (13 per cent) in 2002. Egypt, which was a major tea destination for Sri Lanka's tea in the late 1980s declined gradually with the formation of COMESA in 1994. Tea exports to Pakistan too declined gradually over the years due to competition from Kenya and India. Sri Lanka is now negotiating with Egypt and Pakistan to obtain more favourable arrangements. Such negotiations may help Sri Lanka to regain its export market for tea in these countries.

Exports of natural rubber have declined both in absolute and relative terms over the years. In the recent past, except in 2002, international rubber prices have been declining trend and therefore, total export earnings declined significantly. However, this decline was partly attributable to improvements in domestic rubber based product industries which resulted in an increase in rubber based product exports. Sri Lanka now produces large varieties of rubber based products such as tyres and tubes, surgical and industrial gloves, pharmaceutical articles, apparel and footwear, mats, belts etc. and exports mainly to USA, Belgium, UK, Germany and France.

Contribution from coconut products to total exports has declined over the years but the industry too showed product diversification over the years. The share of the traditional kernel products, namely desiccated coconut, coconut oil and copra, declined from 53 per cent in 1998 to 35 per cent in 2001. New kernel products such as coconut milk powder, coconut cream and defatted coconut as well as coir and coconut fibre based products are now replacing the traditional products.

Imports

A significant change in the import structure in favour of intermediate and investment goods has been observed following the economic liberalisation. Expansion in the industrial sector called for higher imports of intermediate goods, increasing their relative importance in total imports. The share of intermediate goods increased from 42 per cent in 1977 to 57 per cent in 2002. Developments in infrastructure facilities and the construction and transport sectors, combined with increased use of advanced technology, enhanced the imports of investment goods. The share of investment goods increased from 12 per cent in 1977 to 24 per cent in 2000. The share of consumer goods in total imports de-

Table 8- Composition of Imports

Category	Imports (US$ Mn.)				Percentage Share (%)			
	1977	1987	1997	2002	1977	1987	1997	2002
1. Consumer goods	275.0	[illegible]	[illegible]	[illegible]	[illegible]	23.5	20.5	21.5
Food & drink	260.0	327.0	78?.0	696.0	38.7	[illegible]	[illegible]	[illegible]
Rice	103.0	29	72.0	9.0	16.3	1.1	[illegible]	[illegible]
Sugar	22.0	21.0	84.0	38.0	3.2	[illegible]	[illegible]	[illegible]
Wheat	[illegible]	[illegible]	[illegible]	130.0	17.0	3.7	2.4	2.1
Other	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	6.8	5.3
Other consumer goods	22.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
2. Intermediate goods	[illegible]	[illegible]	[illegible]	[illegible]	42.2	39.6	53.7	57.2
Petroleum	102.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Fertiliser	6.0	85.0	94.0	79.0	0.9	[illegible]	[illegible]	[illegible]
Chemicals	[illegible]	[illegible]	96.0	156.0	2.1	2.6	3.3	2.5
Textiles and clothing	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	18.8	28.7	21.8
Other intermediate goods	100.0	[illegible]	909.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
3. Investment goods	[illegible]	[illegible]	[illegible]	1,100.0	12.4	9.7	22.5	9.2
Machinery and equipment	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	13.7	[illegible]
Transport equipment	25.0	[illegible]	[illegible]	[illegible]	[illegible]	2.3	3.8	[illegible]
Building materials	15.0	24.0	273.0	272.0	[illegible]	[illegible]	[illegible]	4.5
Other investment goods	1.0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	1.8
4. Unclassified imports	[illegible]	[illegible]	[illegible]	[illegible]	1.3	1.9	3.5	2.0
Total imports	[illegible]	2,055.0	5,832.0	6,105.0	100.0	100.0	100.0	100.0

Source: Sri Lanka Customs

Table 9: Changes in the Direction of Foreign Trade (a) US$ Mn.

Group of Countries	1977		1980		1990		2000		2002	
	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports
Industrial Countries	575	306	[illegible]	[illegible]	[illegible]	[illegible]	4,1[illegible]	[illegible]	[illegible]	[illegible]
Of which										
United Kingdom	25	196	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
United States of America	113	96	453	203	364	23	2,192	233	1,754	210
Developing Countries	[illegible]	1,066	[illegible]	1,211	[illegible]	2,012	1,106	1,002	[illegible]	1,210
Of which										
Africa	[illegible]	[illegible]	40	[illegible]	40	37	[illegible]	36	33	30
Asia	153	457	[illegible]	1,073	361	2,032	474	3,880	413	[illegible]
Europe	7	23	31	30	57	43	79	23	33	28
Middle East	242	151	206	303	[illegible]	301	438	903	[illegible]	130
Western Hemisphere	4	50	30	21	54	132	56	87	72	46
Centrally Planned	33	[illegible]	45	12	[illegible]	15	115	1	[illegible]	11
Of which										
USSR/Russia (b)	61		71	3	23	5	123	2	27	2
Memo:										
European Union (c)	226	479	506	408	1,224	802	1,318	601	1,263	503
CIS Countries (d)					97	5	43	3	72	3

(a) Direct... [illegible]
(b) Data for 1990 and before refer to USSR
(c) Comprises the EU member countries Austria, Belgium, Luxembourg, Denmark, Finland, France, Germany, Greece, Ireland, Italy, the Netherlands, Portugal, Sweden, Spain and UK
(d) The CIS countries are Russia, Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Tajikistan, Turkmenistan, Ukraine, Uzbekistan and Baltic countries – Estonia, Latvia and Lithuania

declined from 42 percent in 1977 to 23 percent in 2002.

Direction of Trade

As shown in the Table 9, the direction of trade in Sri Lanka changed dramatically over the last 25 years although it has not changed significantly over the last 5 years. The 1977 policy reforms opened a new chapter in a move towards open free trade with all countries. With the rapid expansion in industrial activities and the diversification of the export structure, USA became the largest single buyer of Sri Lanka's exports after 1979. In 2002, USA, which imported garments, tea, rubber and rubber products, coconut and other industrial products, accounted for 38 percent of the total exports from Sri Lanka. The UK, the second largest buyer, and Germany, the third largest buyer, accounted for 14 percent and 4 percent of Sri Lanka's exports, respectively. Garments accounted for 79 percent of goods exported to the UK. Japan is one of Sri Lanka's major markets for crustaceans, machinery parts and accessories, tea, fish products and precious stones. Out of the total exports to Germany, garments and tea accounted for 13 percent and 29 percent, respectively. As a result, the industrialised countries taken together as a group, which had lost importance since the early 1970s, regained their position as the major export partner. These countries accounted for 74 percent of the total exports in 2002. The heavy concentration of Sri Lanka's exports to Western industrial countries made them, as a group, Sri Lanka's largest trading partner.

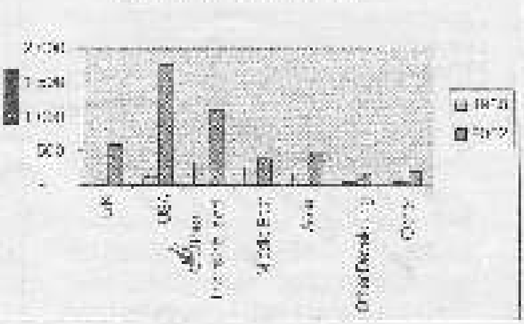
Industrialised countries, as a group, which dominated Sri Lanka's import markets until 1980, have since then taken second place behind Asian countries (excluding Japan). This shift is directly related to the heavy inflow of foreign capital into Sri Lanka's manufacturing sector from the East Asian industrialised countries such as Korea, Hong Kong and Singapore in recent years. Consequently, raw material imports for such industries from these countries have grown significantly in recent years. The emergence of India as the largest exporter to Sri Lanka was due to heavy imports of transport equipment, vehicles and parts, cotton, iron and steel, cement, machinery, pharmaceutical products and food items such as rice, onion, red lentils etc. The relatively low cost of these items in relation to those imported from industrialised countries due to the devaluation of the Indian rupee in March 1993 led to a growth in imports further increasing its share of 4.5 percent in 1990 to 10 percent in 2000. Resulting from the Free Trade Agreement with India, imports from India increased to 14 percent in 2002. Accordingly, Asian countries, as a group, continued to be the major origin of Sri Lanka's imports.

The relative importance of Middle East countries for exports has declined in recent years due to the emergence of CIS countries as major importers of Sri Lankan tea. Since 1990, the CIS countries as importers of Sri Lanka's tea have to some extent replaced the role played by the former USSR. The CIS countries, the major buyer of Sri Lankan tea, accounted for 4 percent of total exports in 2002.

In the recent past Sri Lanka's export structure has diversified to a certain extent, by moving from primary agricultural products, which are subject to irregular and frequent fluctuations, to relatively more stable industrial exports. However, 52 percent of total exports and about 70 percent of industrial exports are yet from the textile and garment industry. In 2002, 38 percent of raw materials imported were used by this industry. With all these changes in the composition of exports, Sri Lanka still remains vulnerable to external shocks as the move was mainly from dependence on primary commodities to one single industrial commodity. In the case of imports, their direction changed from industrial countries to Asian countries but export markets remained virtually unchanged over the last several years.

Chart 5

Direction of Exports



International Trade Relations

After regaining Independence, Sri Lanka became a member of several bilateral, regional and multilateral groupings. Following the establishment of the Central Bank, Sri Lanka became a member of the International Monetary Fund (IMF) and the World Bank on 29 August 1950. Since 1955, Sri Lanka has been a member of United Nations (UN), and a large number of UN related organisations. The Generalized Agreement on Trade and Tariff (GATT) established in 1948, is now graduated to a fully fledged World Trade Organization (WTO). Sri Lanka has been a member since the inception of WTO in 1994.

Sri Lanka became a member of G-77, a group established at the United Nations Conference on Trade and Development (UNCTAD) in 1964. The purpose of this group is to look after the special interests of poorer nations. A subgroup called G-24 was set up in 1972 to look after the interests of the poorest and the most vulnerable countries. Sri Lanka is one of the founder members of G-24. A similar grouping, G-15, operates to promote South-South consultation and coordination where the South concerns poorer developing countries. Sri Lanka became a member of G-15 in 1990.

Sri Lanka receives preferential tariff under the Generalized System of Preferences (GSP) as well as from the Global System of Tariff Preferences (GSTP). Under GSP Sri Lanka and other developing countries receive concessional tariff rates from participating developed countries. Under GSTP Sri Lanka exchanges tariff concessions with other participating developing countries.

Sri Lanka's first regional preferential trading agreement is the Bangkok Agreement established in 1975. Sri Lanka became a founder member of the Asian Clearing Union (ACU) in 1975. The ACU is basically a settlement system that promotes trade among the members. With the establishment of the South Asian Association for Regional Cooperation (SAARC) in 1985, Sri Lanka embarked on regional cooperation in areas covering economic, social and cultural aspects. The South Asian Preferential Trading Arrangement (SAPTA) was established in 1995 with the objective of extending tariff concessions among members. Related to SAARC is the SAARCFINANCE, an organisation of Governors of South Asian Central Banks and Secretaries of Ministries of Finance established in 1998, whose main objective is cooperation on financial issues. Sri Lanka is also a member of the Indian Ocean Rim Association for Regional Cooperation (IOR-ARC) established in 1997 and Bangladesh, India, Myanmar, Sri Lanka, Thailand Economic Cooperation (BIMST-EC), which was established in 1998. Plans are underway to establish a South Asian Free Trade Agreement (SAFTA) in the future.

Sri Lanka continues to have bilateral economic cooperation agreements with a large number of countries in various parts of the world, e.g., Western and Eastern Europe, North America, Latin America, Africa and Asia.

Sri Lanka's most far reaching agreement was the Free Trade Agreement with India established in 1998. The agreement is to remove tariff on freely tradable goods between the two countries. The duty removal will be in full with respect to selected items and partial with respect to a large number of other items. Duty will not be removed with respect to agricultural produce as well as some items with significant domestic production. The agreement was made operational with effect from February 2000.

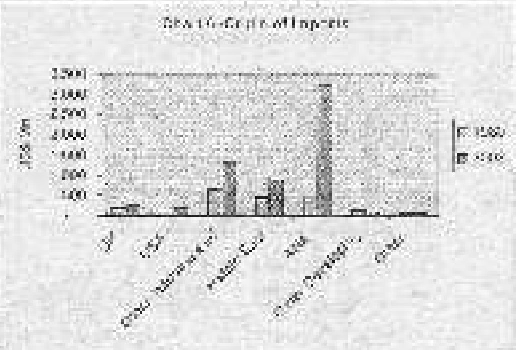
The Framework Agreement for a Sri Lanka – Pakistan Free Trade Agreement was signed on 1 August 2002 in Colombo with the objective of establishing a free trade area for movement of goods and services. Annexes containing offers of both countries and Rules of Origin criteria were to be finalised in due course after the signing of this agreement.

Sri Lanka signed a Trade and Investment Framework Agreement (TIFA) with USA on 25 July 2002. The TIFA creates a legal and institutional foundation for a continuous trade policy dialogue spanning a wide range of bilateral and international trade issues. The broad objectives of the Agreement are to create an environment conducive to international trade, investment and economic cooperation and work towards facilitating greater access to the markets of both countries. Sri Lanka is in the process of entering into a bi-lateral agreement with Egypt. The first round of negotiations on the proposed FTA with Egypt was held during 8-9 April 2003 in Colombo.

Both regional and bi-lateral trading agreements are moving at a faster pace than the multilateral trading system in respect of trade liberalisation and market access. They have contributed positively to the integration of developing countries into global economy. These agreements can promote economic growth through increased competition and provide destinations to the exports if a country is willing to accept economic changes and its physical, social and legal infrastructure is conducive to acquiring benefits from liberalisation. Under these agreements, participating countries demand greater access to the domestic market. Similarly, those agreements pave the way for Sri Lanka's entrepreneurs to have access to their markets. To derive tangible benefits from those agreements and resulting market access opportunities, domestic industries should be sufficiently competitive and Sri Lanka's macroeconomic environment and infrastructure should facilitate improving the country's competitiveness. If factors supporting competitiveness are lacking, the agreements generate asymmetric benefits at the expense of the less competitive partners. The benefits that Sri Lanka has already achieved through most of those international arrangements are not very substantial, but Sri Lanka's involvement in multilateral, regional and bi-lateral agreements can be considered a positive development toward reaching the ultimate objective of integrating into the global economy.

Chart 6

Origin of Imports



Future Directions

Both imports and exports continued to improve during the first four months of 2003, maintaining the growth momentum achieved in late 2002. Exports and imports increased by 13 per cent each during the first four months of 2003. The global recovery strengthened the market for Sri Lankan products, particularly garments, machinery, mechanical and electrical equipment, rubber based products, diamonds, crustaceans and molluscs, fish products and plastics. Towards the second quarter of 2002, all major export categories, except tea, indicated faster recovery while the volumes of intermediate and investment categories of imports showed a gradual improvement, indicating signs of potential growth in future exports.

All major categories of industrial exports are expected to increase during the second half of the year. With continuing growth in coconut and minor agricultural products, better prices in rubber and the expected recovery in tea exports, agricultural exports are expected to record a higher growth during the second half of 2003. Tea production in Sri Lanka was lower than expected during May and June, lowering the projection for total tea production for 2003. However, production is expected to recover during the latter half of 2003. With these developments, total exports are expected to record positive growth in 2003 as against the 2.4 per cent drop in 2002.

The continuous growth in international petroleum prices and rising prices of other commodities will raise the import bill, although relatively lower rate during the sec-

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

R.H.S. Samaratunga

[illegible]

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 expansions and deepening existing ones. Many developing countries have formed preferential integration arrangements since the 1960s. However, this process has been seen, almost entirely as failures by late 1970s.

There are two phases of regional economic arrangements in developing countries. The first phase is in early, in general, on import substitution (IS) policies with excessive government intervention that focused more on industrialization of small scale economies in the regional context, while the second phase is based on outward orientation with an open economic regime. The former started in the late 1970s and the latter started from the mid-1980s. Most countries have turned towards regionalism in the mid 1980s after taking vigorous yet 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 has become today present one of the key developments shared 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 one further 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 labour. By this stage, restrictions on both trade in products and factor movements 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 countercyclical policies is considered as 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 general 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 provide the basis 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 favoured 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 obligated 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 thereby non-member contracting parties are discriminated against and as a consequence, if strictly applied, formation of preferential integration schemes would be banned. Contrary to the spirit of the Article I, however, several exceptions are permitted in the GATT itself which accommodated several conditions at the time of the establishment of the GATT and thereafter. They are:

(i) Article XXIV provides for exceptions 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 this decision, developed countries can extend preferential treatment to developing countries while developing countries can also provide preferential treatment among themselves. Hence, this provision is also to encourage integration 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 mutilateralism. 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 successfully diversified external trading partner sources by late 1960s while achieving economic integration objectives in trade policy. The country choose to follow import substation (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 licences. 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 negonations in this period, particularly after the 1990s. Sri Lanka continued to expand its regional 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 for the World Trade Organization (WTO), consolidating 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 28 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 of reduced tariffs and elimination of non-tariff barriers. A National Schedule of Concessions by Sri Lanka under GSTP covers 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 regional economic integration arrangements although the earlier attempts at regional economic [illegible] only from the mid 1990s. Those 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 reached 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 liberalisation 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 2[illegible] November 1976.

Two rounds of negotiations were conducted under the agreement in 1975 and 1990 and the total products given preference in the agreement list was 104 and 409 respectively. When the agreement was signed in 1975, trade between member countries was around 1 per cent. It rose to 2.4 per cent in the case of exports and 2.2 per cent of their world exports and imports by the late 1990s. India held the largest share of the total intra-exports. Korea accounts for over 40 per cent. 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 1995 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 Afghanistan, Mongolia, Nepal, Vietnam, Cambodia have shown willingness to join the group. The BA membership is open to all developing countries in the ESCAP region.

The Bangkok Agreement is said to be [illegible] of intra-regional trade [illegible] differences in approach, inter-[illegible] very few tools 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 arrangement is confined mainly to tariff reductions on a relatively small range of goods [illegible] covered. BA has two levels of tariff concessions – 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 formalisation of the regional cooperation took place in 1985 with the adoption of the Charter of the South Asian Association for Regional Cooperation (SAARC) at the summit of the heads of state/government held in Dhaka, Bangladesh. The region [illegible] of conflict in inter-state relations, initial cooperative programme was limited to areas of mutual confidence building, non-conflictual and informal 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 selected IPA areas took place over the years 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 2006. The SAPTA has concluded three rounds of tariff reduction in 1995 and 1996, and 1998. The two stages of the process have been very [illegible] SAARC approach [illegible] gradual movement, dealing [illegible] 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 as a PTA as it relates to the establishment of FTA. It has selected only a very low number of preferential tariff lines under its trade liberalising 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 tariff, 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, (c) [illegible] sectoral basis and (d) direct trade measures. Although SAARC has agreed to [illegible] This situation [illegible] 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 10 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 substantial. 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 26the 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 8 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 working on 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 intergovernmental 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 1990s.

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 outward 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 the 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 explore the possibilities 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 trading and/or economic group.

This, as it stands up to now is a preferential trade cum economic cooperation organization. Initial studies have shown 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, trade measures and border crossing towards forming a free trade area are now complete and the development of the framework agreement is underway. 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 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 liberalization efforts since the mid-1970s, Sri Lanka's trade integration is confined to a few developed countries, as has been the case for many developing countries. About 70 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 326, while 94 other tariff lines were offered to LDC members as special concession. However, after the accession of China the total number of tariff lines under general concession for all went up to 1553 while tariff lines under special concession given to LDC members rose to 1[illegible]. This improved the prospect for enhanced trade integration among the membership. Sri Lanka's trade with the group remains very low at 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 of her total. The only notable trading partners in the group other than India are Korea and China (PRC) whose share remain less than 5 percent. Even with them, imports are predominant [illegible] of Sri Lanka's trade with the group.

Sri Lanka's trade with the SAARC region is around 10 percent, of which India alone 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 hurdles. One of the key reasons for the low level of trade integration has come from the 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 within South Asia. Hence, the impact of SAPTA on Sri Lanka continues to remain marginal. It is shown that Sri Lanka has considerable levels of trade complementarities with Pakistan and India. If countries succeed in concluding 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 her 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 15:1 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.

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ond half of 2003. In addition, the expected expansion in exports will require an increase in the volume of imported raw materials and investment goods. As growth in many sectors, including textiles and garments, are expected to continue in the future, demand for raw materials and energy consumption will be higher. Rehabilitation and reconstruction work in flood affected areas too could create demand for building materials. Therefore, the demand for intermediate and investment goods is expected to increase during the rest of 2003. Hence, total expenditure on imports is also expected to record much higher growth in 2003 as against the 2 .2 per cent growth in 2002.

The current trade and tariff policy is to facilitate export led economic growth by creating an environment conducive to enhancing competitiveness in the export sector. The tariff structure was simplified and tariff rates were reduced. Non tariff barriers and lists of exemptions are maintained at a minimum level. The policy direction towards simplified, liberal and less protective tariff policy regime has been maintained even though the simplified tariff policy regime was disturbed from time to time by imposition duty surcharges, changing tariff rates, granting adhoc duty waivers and exemptions etc. The current policy thrust is to continue in the same direction and achieve a low and single rate tariff structure with minimum distortions.

The export structure diversified from primary agricultural products to industrial products during the first one and a half decades after economic liberalisation, but little significant change has occurred thereafter. Textiles and garments and tea yet dominate the export sector. Export markets too are heavily concentrated in a few large regions. These features make Sri Lanka vulnerable to external shocks. External factors were identified as the major contributor to the economic slowdown in 2001. According to past experience, Sri Lanka's economy is sensitive to the changes in tea prices, demand in the USA and the EU for garments and petroleum prices. Some diversification of products and destinations can be seen in the recent past but at a very slower pace. Therefore, diversification of products as well as markets should be a major part of future plans for the development of external trade.

With the expected developments in the industrial, construction and service sectors and large inflows of foreign capital inflows, imports of raw material and investment goods will increase in the future. The increase in income levels will rise the demand for consumer goods too. In the long run Sri Lanka's policies should be directed towards developing industries which are based on domestic raw materials and to encourage local or foreign partnerships to export more value added products rather than primary forms of agricultural products. This will help Sri Lanka to increase net foreign exchange earnings and improve the trade balance.

Sri Lanka's major export product, garments is confronted with numerous challenges. Since the late 1970s Sri Lanka's garment exports have largely been governed by the Multi Fibre Arrangement (MFA). However, under the Uruguay Round Agreement on Textile and Clothing, textiles and garment exports are expected to fully integrated to normal rules of the World Trade Organisation (WTO) by 2005. Sri Lanka as a garment exporter has shown signs of positive improvement in many aspects, but, even at present, more than 52 per cent of their country's garment exports are under quota. However, Sri Lanka's dependence on quota is very much lower than other South Asian countries. Besides the dependence on quota, remaining weaknesses in the domestic industrial and export structure, labour markets rigidities and the strong competition in the international trading environment are also major issues that need urgent attention for survival in a quota free market environment. Hence, the future of the garment industry will depend on the competitive edge that Sri Lanka has among her competitors in Asia, Latin and Central American and emerging producers in Africa and Eastern European which benefit from favorable trading arrangements with major markets. Therefore, Sri Lanka must use its international goodwill to build trade relations with major partner countries to enhance the benefit of international trade relations. Accordingly Sri Lanka's future trade relations are focussing more on major trading partners, such as USA, EU, Russia and Pakistan with an aim to benefit from preferential treatment and to improve market access.

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Rupa Dheerasingh, Senior Economist/ Head, Trade and Commodity Studies Division, Central bank of Sri Lanka

Footnotes

[1] Excluding two aircraft imported under the re-fleeting programme of Sri Lankan Airlines.

[2] Includes Indonesia, Malaysia, the Philippines and Thailand

[3] The Common Market for Eastern and Southern Africa (COMESA) with 21 members signed on 5 November 1993 and ratified on 8 December 1994.

[4] The UN was established in 1944. The IMF and World Bank were established in 1945

[5] The member countries of the Bangkok Agreement are India, Bangladesh, South Korea, Laos, and China.

[6] The member countries of the ACU are Bangladesh, India, Iran, Nepal, Pakistan, Sri Lanka and Myanmar.

[7] SAARC members are Bangladesh, Bhutan, India, Nepal, Maldives, Pakistan and Sri Lanka.

[8] The member countries of the IOR-ARC are Bangladesh, India, Iran, Nepal, Pakistan and Sri Lanka.

International Trade & Economic Growth

A Review of Economic Growth & Trade in Sri Lanka in Relation to Non-Plantation Agricultural Sector

Mahinda Henegedara

Senior Scholar/Research Fellow
Dept. of International Economics & Trade, School of Economics, Huazhong University of Science & Technology, Wuhan, China.

This article reviews the effects of international trade on economic growth with special reference to growth experience of non-plantation agricultural sector in Sri Lanka. The article consists of three sections. The section one describes the theoretical and background information in relation to growth and international trade. It include conceptual base for trade and growth, magnitude of international trade, past experiences of international trade as a strategy of growth. The section two presents Sri Lankan experience on trade and economic growth in the past two decades since its inception of trade liberalization in 1977. It highlights macro economic background, trade policy regimes, main policy instruments and effects and impact of international trade as a strategy of growth. The final and the section three concludes the article by summarizing the implications.

Background

International trade and economic growth are interconnected factors. Expanded trade would cause to raise the level of Gross Domestic Product (GDP). Conversely, economic growth can affect the type of goods a country is able to trade. An increase in exports by utilizing unemployed resources will lead to an overall expansion of production, employment, balance of payment and living standard of people (Husted and Melvin 2002). International trade also allows for purchase capital goods from foreign countries and equip technological advances achieved around the world. Thus due to the fact that tangible benefits, all developed and developing countries followed trade policies as the main strategy of development and consequently International trade, international investment and international immigration were grown rapidly over the past 1200 years. As indicated in Table 1, world trade as a proportion of world output has increased about five fold during 1950 and 1992 period while exports increased ten fold at the same period, indicating 14% increase in 1992 (Hendrik Van Den Berg, 2001).

Growing trade relationship between countries involves many things. The growth of international trade in goods and services is not meant just mere the trade; it also includes flow of people and capital across the borders that make more contribution to increase world productivity. Hence, international investment, international trade and international migration become the main economic elements interdependence of the world economies, which commonly defined as globalization (Hendrik Van Den Berg, 2001). Because of the trade and growth, many developing countries pursue primary export led development strategies or inward looking policies that encourage the production of exports. Some of the countries like Korea, Taiwan, China and Singapore were in successful achieving economic development in the recent past.

Magnitude of the trade is measured by the index of openness. The estimation is the ratio of exports to GDP or GNP multiplied by 100. The openness ratio of trade to GDP has been increased in many countries from 15 percent in 1948 to 27 percent in 1997. According to estimates of Husted and Melvin (2002), in 1950-1998 period, the ratio of exports to GDP was between 10 and 40, indicating that exports accounted for between 10 and 40 percent of the GDP. Further it indicates that the average value of ratio has increased from 20-30 in most countries. In general, countries that were closed in 1960 tended to be much more open in 1998, indicating that international trade has become increasingly important to the world economy. At the same time, the composition of world trade shifted from agriculture to manufacturing and finally to services. In Asia, most developing countries managed to achieve the average growth rates around 5 percent to 7 percent per year since 1960s mainly due to outward looking growth policies (WTO, 1998).

The empirical evidence on international trade and economic growth suggests that there is a positive relationship between international trade and economic growth (Hendrik Van Den Berg, 2001). Empirical evidences were mainly based on openness to trade. According to Sebastian Edwards (1993), shows that outward oriented economies have higher rate of growth compared to moderately outward oriented and strongly inward oriented economies. Jeffery Sachs and Andrew Warner (1995) also showed a strong relationship between openness and growth in developed countries and developing countries. Thus, within the group of developing countries open economies grew 4.49 per year and closed economies grew 0.69 per year while within the group of developed countries the open economies grew 2.29 per year and closed economies grew 0.61 per year. Ross Levine and David Renelt (1992) confirmed that positive relationship between trade and growth. Statistics show that expanding trade and capital flows in an appropriate regulatory environment, have generally coincided with strong growth and political stability, specially for those economies which have welcomed liberalization of world trade faster than world output by a significant margin, increasing the degree to which national economies rely on international trade and foreign direct investment (FDI) in growth promoting activities (WTO). Further, the short term and long term capital flows were also grown. The average daily turnover in foreign exchange markets has increased from about US $ 200 billion in the mid 1980s to over US $1.2 trillion in end of 1990s (WTO 1998). The improved international transport system with information technology directly influence the growth trends in most countries. Therefore, all countries are very very more closely than at any time in the history.

Table 1: World Exports and per Capita Gross Domestic Product (1820-1992)			
Year	World Exports (1990, $ millions)	World GDP (1990, $ millions)	Exports and World GDP (%)
1820	7,255	694,772	1.04
1870	56,247	1,127,373	4.99
1913	236,330	2,725,065	8.67
1929	334,408	3,696,156	9.05
1950	375,765	5,372,330	6.99
1973	1797,199	16,064,474	11.19
1992	3785,619	27,994,920	13.52

Source: Angus Maddison (1995), Monitoring the world economy 1820-1992, Paris OECD, pp228-239

Theoretical background

Theoretical background of the growth and trade policies proves that the majority of economists work in favour of free international trade over protected trade. From the beginning of Adam Smith, David Ricardo in the eighteenth and nineteenth centuries, economists have developed very sound arguments to prove international trade is very effective to improve growth and human welfare. Trade permits economies to specialize in producing goods and services according to the comparative advantage of the respective country. Theoretical arguments presented by classical and neo classical economists on support of free trade and economic growth could summarize as follows (*Hendrik Van Den Berg, 2001;Krugman, 2000, Quiyn, 2001)*:

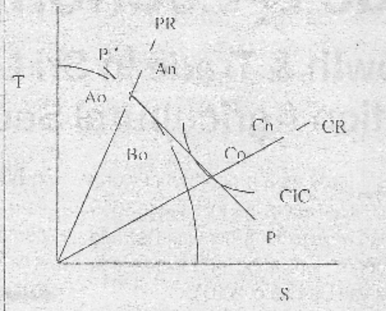
- ❖ Short run welfare gains based on the exploitation of comparative advantage theory,
- ❖ Short run welfare gains based on the exploitation of increasing return to scale,
- ❖ Medium run welfare gains based on the transition to higher steady state following the gains in production efficiency brought by comparative advantage and economic scale,
- ❖ Long run gains from acceleration of technological progress due to larger production and investment externalities following the increase of real output and investment resulting from the short run and medium run effects,
- ❖ Long run gains from acceleration of technological progress due to the expansion of R&D activity stimulated by worldwide, rather than just domestic demand for new products. The increase competing innovators in the worldwide economy, and the reduction in the cost of innovation due to international flow of ideas and knowledge.

Trade And Growth

Irrespective of any government policies and theories, there is always a tendency for economic growth to occur (Husted and Melvin, 2002). For instance, increases in population imply a growing labor force. Investment in new plant and equipment by firms implies a larger and larger capital stock. Likewise, technological advances in the world indicate that allow for higher efficiency in production. Thus, despite these general tendencies in economic growth over the world, international mobility of production factors and technological innovations were greatly influenced for development of the modern world (*see* **Table 1**). Moreover, the manner in which a country grows will also have implications for its pattern of trade. The relationship between trade and growth could explain by using a model example that based on certain assumptions. Thus, it was assumed that an economy produces two commodities (textile and Soybeans) by using only two production factors (labor and capital). It also assumed that the economy is small and it takes world prices as given by the world market.

Economic growth can be described graphically as an outward shift in a nation's production possibility Fortier (PPF) curve (*see* **Fig.1**). Thus, if one production factor grows, then the PPF will expand largely in the direction of commodity, which enjoys its comparative advantages.

Fig.1: Pattern of Production, Consumption and Growth



Before growth occurs the nation's production point is at Ao and consumption is at Co. The international price of S is given by the slope of the price line PP. At that price, the country exports AoBo unit of T and imports BoCo units of S.

The lines of PR, CR & CIC show level of production, consumption and utility.

If both factors grow, then PPF tends expands more uniformly in all directions. If two factors grow exactly the same rates, then the overall capital labor ratio will remain unchanged over time.

Growth necessarily affects with production and consumption. This is because the price line that is tangent to the PPF will also be shifting out with growth, reflecting fact that a nation with growing endowment of productive resources is able to undertake growing amount of consumption. **Thus, since growth affects both production and consumption, it tends to affect international trade**, because international trade is the difference between a nation's production and its consumption as indicated in the equation.

C+I+G+X=Y+IM (*Where C= consumption, I= Investment, G= Government Expenditure, X = Exports, Y= annual income and IM= Imports.*

The relationship between growth, production, consumption and international trade were explained under three scenarios (Husted and Melvin, 2002).

❖ *Neutral Economic Growth*: A proportionate increase in all factors and consumption so that trade expands proportionately to the growth of the economy (Husted and Melvin, 2002 p. 283).

❖ *Protrade biased Growth*: When an economy grow because of a relative expansion in the supply of the factor used intensively in the production of exportables, there will be a tendency for the output of exportables to rise relative to the output of the importables and for international trade to rise percentage terms by an amount greater than the percentage expansion of GDP. This type of growth is called protrade biased growth (ibid p. 287).

❖ *Antitrade biased Growth*: When an economy grow because of a relative expansion in the supply of the factor used intensively in the production of the importables, there will be a tendency for the output of importables to rise relatively to the exportables and for the international trade of this country to fall. This type of trade is called antitrade-biased growth (ibid p. 287).

The relationship between growth, production and trade is varied according to technological change and international mobility of production factors, specially labour and capital.

Technological Change.

Technological change occurs when the same amount of output can be produced by fewer factor inputs, or equivalently, when the same amount of inputs can produce greater amount of output. As a result of Innovations and Research, & Development (R&D) activities over the world, technology become an important production factor, and many countries were able to receive easily benefits of technological advancement, which increased the production efficiency. Technological change could occur in two ways:

❖ *Neutral Technical Change*: An innovation that results in an equiproportionate reduction in the use of all factors in the production of one unit of output.

❖ *Labour (capital) saving technical change*: An innovation that result in a more than proportionate reduction in the use of labour (capital) relative to other factors in the production of one unit of output.

Mobility of Production Factors

A country can also grow by acquiring production factors (labour and capital) from other countries. For instance, the growth of the United States in the last century was occurred due to the considerable immigration of foreign workers and inflow of foreign capital. Factor inflows from foreign countries tend, to raise welfare in the host country and to lower welfare in the source country (Husted and Melvin, 2002).

Because of the strong relationship between trade and growth, all developing countries peruse outward looking or primary export led development strategies that encouraging the production of exports. According to past experience of newly developed countries like Singapore, Korea and Taiwan, it seems that many countries were successful in achieving development through trade.

Though there is a very strong theoretical relationship between international trade and growth, which was proven by empirical evidence, many countries follow trade restrictions due to some arguments *i.e.* strategic trade, infant industry and import substitution (Korea, 2000). Some empirical evidences also proved that many developing countries were not benefited from the trade as expected (Roy, 1999).

Trade and Growth in Sri Lanka

Sri Lanka is a semi-developed country with an area of 65,610 sq. km and a population of 18.7 million as estimated in 2001. According to Central Bank estimates (2001), per capita income was US$ 880 (Rs. 68,482). The agriculture sector plays a dominant role in the economy and accounts for 19 percent of gross domestic product (GDP), 19 percent of total exports and 36 percent of total employed labour force (Central Bank of Sri Lanka, 2001). The majority (72 percent) of the people lives in rural areas and earn their income from agriculture and related activities. The agricultural sector which has the characteristics of a dualistic economy (Snodgrass, 1966), consists of two sub sectors, the non-plantation or domestic food crop sector and the plantation sector. The non plantation sector which mainly consists of paddy, other food grains, maize, soybean, vegetables and perennial crops accounts for 76 percent of the total cultivable lands while the plantation sector consisting of tea, rubber, coconut accounts for 24% of the total agricultural land. Paddy being the main non-plantation and staple food crop accounts for 35 percent of total cultivable lands and about 2 million farmer families were engaged in farming as their main occupation. More than 70 percent of paddy farmers belong to the small farmers category which owns less than one hectare of land.

Like many other developing countries Sri Lanka faced macro economic imbalances in spite of improvements in literacy, health and life expectancy (Weerahewa, 1998). The major economic problems of the country were associated with limited foreign exchange, budget deficits, unemployment, inflation, poverty and the consequence of a slow economic growth rate (Gooneratne and Wesumperuma, 1984). Hence, the economic policies and programs of successive governments since independence in 1948 were targeted economic growth by overcoming macro economic imbalances.

A comprehensive body of literature is available on trade, growth and macro economic Policy reforms in Sri Lanka. Among these are the Works of Wickremaratne (1977), Gooneratne and Wesumperuma (1984), Rasaputra, Tilakaratne and Fernando (1986), Rajapathirana (1988), Bhalla (1991), Kelegama (1991, 2000), Dunham (1993), Lakshman (1994), Gunawardena and Somaratne (1991), Lakshman and Tisdell (1999), Athukorala and Kelegama (2000), Mohamed and Ahamed (2000), Herath et al (2002) and Somaratne (2000, 2002, 2003).

Many of these analysts concluded that though Sri Lanka has been followed liberal trade policies since 1977 and its growth strategy, real achievements in terms of economic development are far beyond the expectations. In spite of this well improved social indicators such as education and health (Mohamed and Ahamed, 2000). Though one time Sri Lanka economy was considered to be a prospective south Asian tiger economy, it still remains un attached partly due to political unrest and social and institutional limitations. However, it seems that trade policies have positively affected to increase production and consumption, which were able to offset effect of general trends in.

❖ Having considered essence of conclusions of many early analysts, focus of this analysis is on assess the past experience of trade policy reforms in Sri Lanka in the agricultural sector with reference in neutral, protective and antitrade scenarios, technological advancements and international factor mobility (labor and capital) discussed in each of [illegible].

Economic and Trade Policies

Over the past fifty years since independence (1948) three distinct policy regimes could be identified with respect to economic growth in Sri Lanka, which were based on political ideologies, development strategies and priorities.

❖ 1948-1970 period: Development policies and programs of this period was mainly based on mixed economic policies

❖ 1970-1977 Period: This period was regarded as protectionist regime because extensive state intervention and inward looking policies were followed.

The Post 1977 Period: Since 1977, Sri Lanka has made a significant progress in moving from inward looking policies to outward looking policies. The policy changes made during post 1977 period, fall into three policy regimes such as the first wave of liberal policy reforms (1977-1988), the second wave of liberalization reforms (1989-93) and the current policy regime: 1994 to date (Gunawardena and Somaratne, 2000).

The First Wave of Policy Reforms (1977-1988)

In this phase, the economy was transformed from a inward looking system to outward looking system. A wide range of economic reforms was introduced during this period aiming at increasing economic growth and improving the balance of payments. Policy reforms introduced since 1977 could be grouped under five sections: Pricing Policies (Price Liberalization), Trade Policy, Monetary Policy, Fiscal Policy and Institutional Reforms (Athukorala, 1993; Kelegama J, 1993; Somaratne and Gunawardena, 2000; [illegible], 2005).

The Second Wave of Liberalization (1989-1993)

The second wave of liberalization reforms were intended to overcome the macroeconomic imbalances due to the mismanagement of the economy and to the accelerated development programs introduced since 1977. The second wave of liberalization reforms took the form of structural adjustment programs (SAPs) as recommended by the World Bank. These included low profile adjustments such as reducing maximum nominal tariff on imports, devaluation of the rupee, high profile projects such as privatization of public corporations and enterprises and export oriented industrialization. The private sector was recognized as the engine of growth and government intervention in production activities was limited to provide economic and social infrastructure facilities. The tariff system was altered from a six-band structure in 1988 to a three-band structure in 1992 and distortions were corrected and tariffs reduced for agricultural and industrial commodities (Presidential Tariff Commission Tariffs Trade, 1994).

The Current Policy Regime: 1994 to Date

Policies followed after 1994 to Date were mainly focused on removing, rationalization of policies and distortions of the market. Eliminate restrictions on institutional and technical factors such as land ownership, credit and infrastructure (Policy Statement of the Government of Sri Lanka, 1995). Privatization of government corporations was further promoted.

Agricultural Policy reforms

Generally in keeping with the liberal economic policy reforms followed since 1977, agricultural policies were focused on achieving four objectives (National Agriculture, Food and Nutrition Strategy, Ministry of Finance and Planning, 1984).

1. Achievements of self-sufficiency in basic foods - rice, milk, sugar, fish and pulses.
2. Expansion of exports to increase the contribution of agriculture to the balance of payments situation.
3. The creation of new employment opportunities and the consequent rise in incomes in the rural sector.
4. The improvement of the nutritional status of the people.

Economic Policy instruments

Since the inception of liberal economic policy reforms 1977, Sri Lanka is implementing a variety of policy options including pricing, trade, monetary and fiscal policy changes as the main strategy of economic development. The declared objectives of such policy reforms were to accelerate economic growth, improve international competitiveness, to create employment opportunities, to increase capacity utilization, to stimu-

Table 2:
Rates of Import tariff imposed on Selected Agricultural Commodities

Products	Tariff			
	1986/88	1994	1996	1998-2001
Ptatoes	100	35% or Rs.12 per Kg	35	35
Red Onions	5	35% or Rs.09 per Kg	35	35
B Onions	5	35% or Rs.09 per Kg	35	35
Green gram	5	35% or Rs.10 per Kg	35	35
Black gram	5	35% or Rs.10 per Kg	35	35
Lentils	5	45% or Rs.12 per Kg	35	35
Others	5	35% or Rs.12 per Kg	35	35
Dried chili	5	35% or Rs.20 per Kg	35	35
Other	-	35% or Rs.10 per Kg		
Maize	5	45%	35	35
Rice	25	35% or Rs.07 per Kg	35	35
Cane sugar		35% or Rs.6,5 perKg	35	35
Beet sugar		35% or Rs.6,5 perKg		
Wheat	25	N/A	20	20
Ginger	60	N/A	35	35
Turmeric	60	N/A	35	35
Saffron	60	N/A	35	35
Seed Anise	5	N/A	35	35
Coriander	5	N/A	10	10
Cumin seed	5	N/A	10	10
Fennei seed	5	N/A	10	10

Source: Sri Lanka Custom Notifications, Department of Customs, (1986/88; 1996; 1998), Report of the Presidential Commission on Tariff and Trade- 1994.

late savings and investments and to improve balance of payments (Gunawardena and Somaratne, 2000, Henegedara, 2002). There are four major strategies that the Sri Lankan agriculture can peruse in reaching the above objectives (Somaratna,2003).

- Integration in to global economy (*i.e.* globalization and regionalization;
- Maintenance of macro economic stability;
- Investment in people and technology;
- Market integration to improve agro enterprises.

Though there are Varity of policy instruments followed since 1977(Aberatne, 1991); this analysis focus only on trade and subsidy programs as the main policy instruments.

Trade Policy Instruments

The tariff system, which was followed as the main instrument of trade policy was replaced by introducing some quantitative restrictions (QRs) on imports. Thus most QRs on imports were replaced in 1988 by introducing a six-band duty system ranging from 0 percent tariff for essential consumer items to 500 per cent tariff for luxury items respectively. This system was altered in 1992 and a three-band structure was introduced with rates of 10, 20 and 45% in order to relax the rigidity and correct the distortions in domestic agricultural sector (Presidential Tariff Commission on Trade and Tariff). The introduction of the three band tariff structure in 1992 helped to reduce market distortions in the non plantation sector (Gunawardena & Somaratna , 1996).

The new trade agreements on agriculture with the GATT/Uruguay Round agreement on Agriculture (GURAA) and the South Asian Preferential Trade Agreement (SAPTA) have opened new horizons and avenues for non-plantation agricultural commodities. In compliance with GURAA, Sri Lanka is bound to have all tariffs on imports of agricultural products at a uniform rate of 50 per cent (Gunawardena and Somaratna, 2000). Thus approximately 700 agricultural products including cereals, sugar, maize, spices, fruits, vegetables, juices and other fruit preparations, milk and meat will benefit under the GURAA and SAPTA agreements.

The official import duty rates imposed on paddy and other commodities were changed from time to time with change in local production and under internal political pressures. According to **Table 2**, the tariff structure has periodically changed since 1980s. It is expected to liberalize tariff structure further and impose a two-band tariff system for all products in line with the agreement of the WTO (Somaratna, 2002). Until 1990 the CWE had a monopoly of import rice, wheat and wheat flour. After 1990, private traders were allowed to import and to maintain buffer stocks subject to the payment of import duties when stocks were released to the local market. Licenses and seasonal restrictions were followed with respect in Potatoes, Chilies and Onions.

According to projections of the macro economic effects of tariff liberalization, tariff is likely to increase to a higher GDP. Tariff liberalization fosters economic growth and improves most macro economic variables by showing a pathway in the right direction for the sustainable development (Somaratna, 2002). However, it shows that the impact of tariff rates on local producers and the consumers is negligible when it compared to Nominal Protection Coefficient (NPC) and the Effective Protection Coefficient (EPC)[2]. According to HARTI statistics based on 1991/92 survey data in four major rice-producing areas, the NPC or the NPR was-8.2 at the rate of official exchange rate and -16.8 at the rate of shadow exchange rate (Wickramarachchi, 2000). It implies that the rice was negatively protected or local producers were taxed. According to the same estimates, (EPC)[3] or the EPR was -9.8 and -21.6 respectively in newly irrigated and rehabilitated irrigated areas at the rate of official exchange rate. The rate was -23.2 and -32.0 respectively in newly and rehabilitated areas in terms of the shadow exchange rate (Wickramarachchi, 2000). This implies that protection had a negative effect on local producers.

Production Subsidies

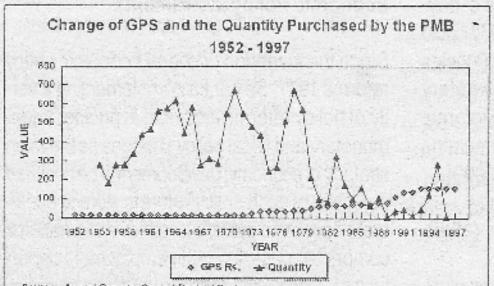
Various form of production incentives such as low prices, low interest rates, and loans were considered as subsidies (Aberatne, 1991). There are two types of subsidy programs were implemented *i. e.* price subsidy and inputs subsidy.

Price Subsidy

Price subsidy was introduced as the Guaranteed Price Scheme (GPS) to purchase paddy (rice) from producers. Though the system was started in the late 1940s, it functioned as the main price mechanism for the purchase of paddy until early 1980s. The main purpose of the GPS was to increase the market prices of paddy and thereby improve the farm incomes (Sirisena, 1986). It was estimated that all paddy growers approximately (1.8 million farm families) would directly benefited from the scheme. The amount purchased by the GPS depended on the volume of production, availability of other food commodities, personal consumption needs and the price in the open market. The performance of the GPS over the past fifty years may be divided into four stages (Sirisena, 1986).

1. The initial stage (1948-1956). In the initial

Figure 2 Effects of Price Subsidies according to Guaranteed Price for paddy (1952-1997)



Source : Annual Reports, Central Bank of Ceylon

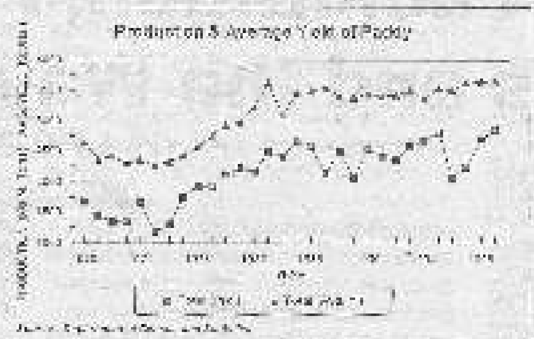
Table 3: The Impact of Agricultural Reforms on Increasing Paddy Production During Three Policy Regimes

Item	Unit	1977-88	1989-93	1994-99	% Change
Production	000'MT	2285	2380	2557	7.4
Average Yield	Kg./Hec.	3125	3449	3555	3.1
Cost of Production of Paddy (Irrigated)		3242'	8307'	12360'	48.8'
	Rs./Acre	2561	6523	8726	33.8
Cost of Production of Paddy (Rainfed)		2447'	7382'	10908'	47.8'
	Rs./Acre	1923	4682	6306	34.7
Gross Return per Acre of Paddy (Irrigated)		4854	11218	16043	43.0
Gross Return per Acre of Paddy (Rainfed)	Rs./Acre	3025	7170	9051	26.2
Net Return per Acre of Paddy (Irrigated)	Rs./Acre	1615'	2911'	3683'	26.5'
	Rs./Acre	2295	4695	7317	55.8
Net Return per Acre of Paddy (Rainfed)		578'	-211'	-1857'	780.1'
	Rs./Acre	1102	2488	2746	10.4

' Including imputed costs for labor and seeds etc.
Source: Department of Agriculture, Data Bank of HARTI

stage the GPS was able to collect a very small share of the marketed surplus due to unattractive prices and lack of credit facilities.

2 In the second stage (1958-1971), the market share of GPS was improved since credit facilities were provided through cooperative societies in 1961. During this period the GPS was always higher than the open market prices and therefore the quantity purchased under GPS was higher (see Figure 1).



Production & Average Yield of Paddy

3 In the third stage (1972-1977) the Paddy Marketing Board (PMB) was established in 1972 in order to implement GPS. The paddy marketing Act No. 15 of 1971, gave wide powers to PMB in purchasing paddy.

4 In the post 1977 period, the monopoly of the PMB was abolished and the GPS was implemented as a floor price. Consequently the quantity purchased under GPS dropped from 80% (1977) to 5% (1997).

The involvement of private traders in purchasing paddy has increased since 1977 and consequently the GPS was increased from Rs. 40/= (1978) to Rs. 160/- (1995) a 300% increase over the period. But the quantity purchased under GPS has not increased commensurate with the increase of the GPS.

According to Figure 1, the quantity purchase decreased during 1980 - 1983 and increased again in 1994 and 1995 due to the intervention of the new government, but it has not increased since 1996 irrespective of an increased GPS. Since September 1996, the PMB has not functioned and the purchasing of paddy is done through the Cooperative Wholesale Establishment (CWE) and [illegible] organisations.

Inputs Subsidies

There were two main inputs subsidies given to farmers i.e. the fertilizer subsidy and the irrigation subsidy.

Fertilizer Subsidy

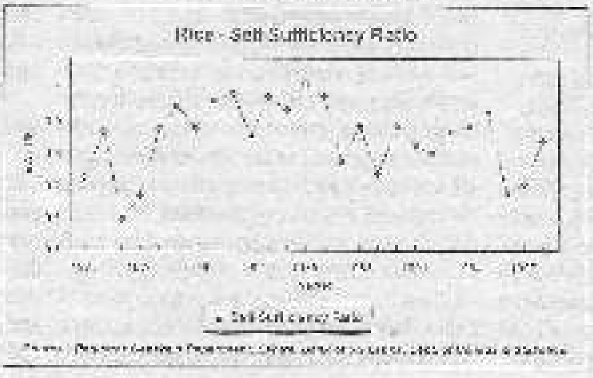
The fertilizer subsidy was introduced in 1962 to encourage the use of inorganic fertilizers in line with the green revolution. The subsidy was given for Urea, Triple Super Phosphate (TSP), imported Rock Phosphate, Muriate of Potash (MOP) and NPK mixtures with 5:15:15 composition. Imported Ammonium Sulphate (AS) was not subsidized from 1981 in order to popularise local production.

The fertilizer subsidy had a positive effect on productivity and total production of paddy (Annual reports, Department of Agriculture). The impact was very significant in the case of high yielding varieties which were used to urea. However the impact of reducing total production cost was marginal due to the fact that the fertilizer accounted for only 13 percent of total cost, though it helped to increase fertilizer application among small producers who were not able to bear the high production costs (Ekanayake, 1988). The fertilizer subsidy was reintroduced in 1994 by adjusting the prices of these varieties.

Irrigation Subsidy

Subsidized irrigation water is the main production input provided for paddy cultivation. Irrigation is provided to farmers free of charge except for a marginal levy that has been imposed for the operation and maintenance of the irrigation systems and now charged for minor irrigation schemes. There are various arguments for and against the irrigation subsidy because it is difficult to estimate irrigation costs alone (Aberatne 1991). However the effective irrigation subsidy has calculated in some studies (Aluwihare and Kikuchi 1991) by taking into account the operational and maintenance costs of new construction and rehabilitation irrigation projects in major and minor irrigation systems. Thus the effective irrigation subsidy for two major irrigation schemes of TMIP and Gal Oya projects (1993) were estimated as Rs.2,287/Ha but it has gone up to Rs.18,840/Ha in the newly developed Mahaweli areas. The effective irrigation subsidy for the rehabilitation of minor irrigation was Rs. 1,586/Ha (1988). According to these estimates the provision of irrigation subsidy has had a major impact on reducing cultivation cost and on increasing cropping intensity from 1.33 m/ha to 1.58 m/ha in the period 1985-1997.

Rice - Self Sufficiency Ratio



Effects and Impact of Trade Policy Reforms

The effects and impact of trade policy reforms on non-plantation agriculture sector can be assessed by examining total production, net returns, consumer welfare and self sufficiency. However due to the lack of non-availabilities of the accurate data, the analysis focuses mainly on paddy.

Total Production

As shown in Table 3 the average paddy production increased during the consecutive five year policy regimes from 2,235 MT (1977-1988) to 2,557 MT (1991-1997). The average yield also increased from 3,125 Kg/ha to 3,365 Kg/ha during the same period. The gross return per acre increased from Rs 4,654 to Rs 13,045 in irrigated areas and from Rs 3,025 to Rs.9,06[illegible] in rain fed areas during two consecutive periods. The net returns per acre increased by 55.8% and 10.4% respectively in irrigated and rain fed areas but showed negative results when imputed values for labour and seeds were included (Table 3). *Figure 3* also indicates the total production and the average yield of paddy during 1978 - 1999 period.

Consumption and Welfare

Domestic rice production and consumption of imported wheat have increased during the consecutive period indicating that steady increase in total welfare. The dependence on rice production has relatively declined in the recent past.

As indicated, Figure 4, self-sufficiency ratio of rice production has increased that the food security and consumer welfare has improved in the society.

Economic Growth

GNP and the growth rates in the agricultural sector and the paddy farming sector bear a close relationship to cropping intensity (Table 5). The growth rate of the agricultural sector fluctuated over the period and indicated some negative trends in 1987, 1989 and 1996. But GNP maintains steady growth indicating 4.8 average annual growth rates.

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Trade Facilitation, Present Problems and the Way Forward

A.P.C. Subhashini Abeysinghe
Economist, Economic Intelligence Unit, The Ceylon Chamber of Commerce

Trade Facilitation - An Overview

High transaction costs of carrying out international trade resulting from bureaucratic red tape, documentation requirements, lack of transparency, duplication and lack of cooperation between traders and official agencies has become a major stumbling block which prevents growth in trade. According to estimates of UNCTAD on average customs transaction involves 20-30 different parties, 40 documents, 200 data elements and the keying of 60-70% of all data at least twice. With the lowering of tariffs, the cost of complying with customs formalities is reported to exceed in many instances the cost of duties to be paid. An APEC[1] study has shown that expected gains from trade facilitation programs are almost double the expected gains from tariff liberalisation. This study points out that the reason why many small and medium size enterprises (SMEs) are not active players in international trade has more to do with red tape rather than tariff barriers. For developing country economies, inefficiencies in areas such as customs and transport have a major impact on export competitiveness and inflow of foreign direct investments.

Formalities, procedures and paperwork in international trade are generated by the need for Government and trade operators to monitor and control the movement of goods, transfer of services and related financial flows. This is necessary in order to safeguard each country's requirements to collect tariff revenues and to control the cross border movement of illegal drugs, arms, protected species, hazardous waste, and other controlled products and to fulfill the information requirements for operational and statistical purposes (UN/CEFACT[2]). However when imposing these, the authorities need to consider the effect of such procedures on the cost and efficiency of the overall trading system. It is important to ensure that these practices are not an economic burden to the trading community and do not discourages many businesses, especially small and medium sized enterprises from trading on an international basis.

Trade facilitation is defined as "simplification, harmonization and standardisation of international trade procedures". Trade procedures are activities, practices and formalities involved in collecting, presenting, communicating and processing data required for the movement of goods in international trade. These relate to a wide range of activities such as import and export procedures, Customs or licensing procedures, transport formalities, payments, insurance and other financial requirements. It is expected to ensure greater transparency, efficiency, and procedural uniformity of cross border transportation of goods. This will result in considerable savings in time, money and human resources.

Simplification is the process of eliminating all unnecessary elements and duplications in procedures. ***Harmonization*** is the alignment of national procedures and documents with international conventions, standards and practices. ***Standardization*** in trade facilitation is developing internationally agreed formats. The benefits of trade facilitation are export growth, improved competitiveness, increased foreign direct investment and increased participation of SMEs in international trade. To make trade facilitation a success there has to be political will and commitment, cooperation from trade and realignment of resources to build capacity of Customs and other relevant government agencies involved in international trade.

There are several initiatives taken at the international level to promote trade facilitation. For example, member nations of the WTO would be negotiating on commitments to strengthen the rules on trade facilitation after the Fifth Ministerial Meeting of the Doha Development round in September 2003, marking the first ever negotiations on trade facilitation. Articles of the General Agreement on Tariffs and Trade (GATT) which are relevant for trade facilitation include Article V, dealing with transit; Article VII, concerning valuation of goods for Customs purposes; Article VIII, dealing with the simplification of documentary requirements and Article X, concerning the publication and availability of information on regulations, etc. relating to the classification of goods, valuation, rates of duty, restrictions, prohibitions etc. Despite the growing realization of the importance of trade facilitation there are mixed reactions from developing world towards a multilateral negotiation on trade facilitation. They feel that such an agreement will further add to implementation burdens for developing countries, which lack resources to modernize customs facilities. However this will no longer be a choice available for developing countries and it is becoming a must in order to promote trade and attract foreign investments. In a highly competitive world environment, international trade and investment will flow towards efficient, supportive and facilitative locations. At the same time it will ebb away from locations, which are perceived by business as bureaucratic and synonymous with high costs.

United Nations Center for Trade Facilitation and Electronic Business (UN/CEFACT) has also taken efforts at promoting trade facilitation as stated in its Recommendation 18 (*3rd edition, March 2001*), which provides a comprehensive set of recommendations regarding international best practices and standards for the facilitation and harmonization of trade transactions, from initial commercial documents to payment measures, official controls and transportation of goods. The recommendation is said to be especially relevant to transition and developing countries which can still significantly improve their economic performance by streamlining international trade procedures.

Sri Lanka

Trade facilitation in Sri Lanka is said to be slow, costly and inefficient. The cost is estimated to be around 10 percent of the value of total imports and exports. Such inefficiencies increase the costs of carrying out business in terms of time and money. This hampers growth prospects for the country, which is heavily dependent on trade and is in dire need of foreign direct investments to achieve the very optimistic growth target of 10 percent stated in the governments' policy document "Regaining Sri Lanka".

To create a simple, transparent and fast trade facilitation system, institutions and processes have to be improved, physical resources have to be provided and adequate training has to be provided to upgrade human resources.

There are a large gamut of Ministries and Departments administering various aspects of international trade in Sri Lanka. A recent survey has revealed that there are about 42 government institutes overlooking international trade transactions. It is almost impossible to discuss the problems associated with all these institutes in a short paper like this within a given short time period. Therefore more attention has been given to Sri Lanka Customs and Ports Authority, which are considered as the most important institutes that facilitate trade.

Sri Lanka Customs

Customs administrations play a vital role in the growth of international trade and the development of the global marketplace. It has to meet the demands made by the rapidly changing trade environment for fast clearance of goods and at the same time fulfilling its legal responsibilities such as collection of revenues, protection of the society and ensure compliance with a great number of international trade agreements. The efficiency and effectiveness of Customs procedures can significantly influence the economic competitiveness of nations. Therefore customs systems and processes must not be allowed to become a barrier to international trade and growth.

Standardization, simplification and harmonization of procedures followed by Customs can greatly reduce costs in terms of time and money. Such measures will reduce the administrative barriers, foster the small and medium businesses to engage in international trade and help to make the country an attractive destination for foreign investments. WTO in its trade facilitation efforts has focused only on Customs, and this alone is evidence to show the important role it plays in international trade transactions.

The Revised Kyoto Convention (WCO, 1999) offers instruments that allow countries to meet their legitimate goals of revenue collection, protection of society and facilitation of trade. The convention not only strengthens the customs control, but also enables facilitation of the trade via simple, standard, transparent and predictable procedures.

Core principles of modern Customs procedures are stated as -

- Transparency and predictability
- Standardization and simplification
- Maximum use of information technology
- Minimum necessary control to ensure compliance
- Risk management to facilitate legitimate trade while maintaining effective control
- "Fast track" procedures for traders with good compliance record ("Authorized traders" concept)
- Co-operation and partnership with all stakeholders including government agencies, the private sector and Customs administrations of other countries.

Customs administration has to meet the challenge of balancing trade facilitation measures, detection of deceptive practices (e.g. under invoicing, dumping) with the security initiatives in an environment where acts of international terrorism and organized crime have become a major concern. *The Resolution on Security and trade Facilitation of international trade supply chain* (WCO) was signed in 2002 as a response to the need to ensure security without compromising the facilitation efforts. The resolution addresses issues related to risk management, advance electronic transmission of standardized Customs data, co-operation with the trade sector, and exchange of information.

Sri Lanka Ports Authority (SLPA)

Given the strategic location of the country as an island in the Indian Ocean close to India and centrally located in respect of Asia, the Far East, the Middle East, Africa and Australia, it is often said that we have great potential of becoming a shipping and a trade and hub in Asia. Trade facilitation is an area, which would enhance the potential of the country to benefit from this natural advantage. At present however, being a latecomer the country has to face severe competition from leading ports in countries like Singapore, Malaysia, Dubai and emerging ones in India.

Traditionally a large numbers of documents are required by customs, immigration, health and other public authorities pertaining to a ship, its crew and passengers, baggage, cargo and mail. Unnecessary paperwork is a problem in most industries, but the potential for red tape is probably greater in shipping than in other industries, because of the international nature and the traditional acceptance of formalities and procedures (International Maritime Organization). Measures have been proposed to facilitate the arrival, stay and departure of ships of coastal and non-coastal contracting states by simplifying and reducing to a minimum the formalities, documentary requirements and procedures.

Too many allied procedures [illegible] are likely [illegible] of the [illegible] trade and it causes [illegible] to the country.

This includes all documents pertaining to the ship and its passengers, baggage, crew, cargo and mail, which are required by Customs, immigration, health and other public authorities.

The Sri Lanka Ports Authority (SLPA) is responsible for the operations of Sri Lanka's three main ports – Colombo, Galle and Trincomalee. It is a port operator, terminal operator, landlord, regulator and policy developer for Sri Lanka's ports. It is the responsibility of the Authority to take appropriate measures with the co-operation of ship owners and port administrations to ensure that satisfactory port traffic flow arrangements are provided so that handling and clearance procedures for cargo will be smooth and uncomplicated.

As an apex body that facilitates trade there is a general satisfaction of SLPA operations. For example with the recent infusion of competition by allowing private sector to operate, the terminal operation has become more efficient. Previous [illegible] flexibility in SLPA operations with respect to working hours and [illegible] arrangements is appreciated. [illegible] activity is low and the management systems in the port rely to some extent on electronic data systems with increasing adoption of paperless transactions between terminal operators and port users on a 24-hour basis.

Sweeping changes have taken place in the scenario of international trade facilitation with the rapid development of technology. Despite being strategically located and having great potential of becoming a shipping and trade hub for the region, Sri Lanka has failed to keep up with these developments. For example with the increasing use of containerized cargo (instead of bulk cargo) the time taken to load and unload cargo has come down drastically. Roughly a task that took almost one day now takes only half an hour. Unfortunately the country has failed to make the maximum use of such changes because other supporting institutions have not upgraded their systems and procedures to accommodate this fast change.

Present Problems

Customs Ordinance

The Customs Ordinance and subsidiary legislation is over 100 years old. Despite being revised for about 20 times since 1978, it is said to be grossly inadequate to accommodate modern requirements of international trade. In addition this gives ample room for Customs administration to use excuses relating to legislation to delay adoption of new systems or procedures required to improve trade facilitation. Revision of the law to suit the current demands is a long felt need. In addition for effective facilitation of trade the law must be constantly reviewed and updated.

Compendium of procedures

According to Article X of GATT on trade facilitation, authorities are obliged to publish all trade related laws, regulations, rulings and agreements in a prompt and accessible manner. Unfortunately in Sri Lanka the various aspects relating to trade are revealed in an ad-hoc manner and the affected parties are not informed promptly.

In addition, lack of a compendium of procedures and detailed documentation for each area of operation is a major concern. As a result, importers and exporters are subject to unnecessary harassment due to their ignorance. Further officers tend to apply procedures as known to them and interpret these to suit their requirements. Since there is no single uniform definition, the interpretation and application of rules and regulations vary from situation to situation.

and person to person. Hence the formalities, procedures, laws and regulations need to be clearly defined and published and made available to the public. This will encourage administration of these in a uniform, impartial and a reasonable manner and reduce room for corruption.

Website for Customs

A regularly updated website giving all relevant laws, regulations, procedures, documents and tariffs is a must in today's context. Sri Lanka Customs launched its website in year 2000. Many appreciate the initiative taken, however there is ample room to improve the site. For example there is a section to report laws and regulations pertaining to Customs, in this at the moment only Customs Ordinance and Sri Lanka Standard Institute regulations for importers are listed. The Customs is the executing authority for over 50 laws pertaining to trade; hence this section needs to be updated. Likewise in many other areas more information can be provided through the site.

Electronic Data Interchange (EDI) System[4]

EDI system is a system that facilitates the electronic recording and transferring of data/information required by Customs. All parties involved (e.g. Customs, Ports, BOI, EDB, Importers, Exporters, Freight Forwarders etc.) are electronically linked for the processing to be efficient. The ultimate objective of EDI is to come up with a one-stop information system, which would eliminate costs and delays associated with presenting documents or goods to different agencies.

The proposal to establish an EDI system was made several years ago. This has been discussed repeatedly on many occasions, but no significant progress has been made. At present there is an Advisory Committee studying this proposal and many expected that this would at last become a reality, as it was announced that this system would be implemented by early 2003. However, according to the private sector representatives who are involved in the process there is a serious doubt whether the proposal, if implemented as it stands now would actually be able to improve the existing system. They indicated that there are several technical and legal issues which are yet to be resolved before implementing. The progress made in these areas is very slow and as a result implementation has been delayed. The private sector is concerned about the outcome if the government decides to implement without actually resolving these issues. Considering the huge cost that is involved in establishing an EDI system, it is very important to resolve the issues as soon as possible and ensure that the benefits to the trade and industry is higher than the costs.

This is a system, which would be expanded to cover all agencies in time to come. Therefore private sector representatives proposed to develop a Single Administrative Document, which would accommodate the requirements of other government agencies before implementation. This would make it easier to gradually absorb the other institutions when the system is in full operation. At the moment sufficient attention has not been paid to this suggestion.

Customs Examination procedures

The existing reward system is severely criticized for being ineffective in reducing corruption and creating unnecessary delays. It is regarded as a waste of scarce Customs resources. Noting that hundred percent inspection of all consignment has become a thing of the past, this system can be regarded as an unnecessary cost to the country both in terms of administration cost and in terms of increasing cost of carrying out business. As a solution to this problem it has been recommended to abolish the reward system and move to professional pay scales.

Training and Skill development - In order to improve examinations the customs need to adopt selective checking based on risk analysis techniques. The customs officers must be specifically trained in this area to enable them to carry out the duties in a professional manner. It is pointed out that customs agents must be highly skilled and have thorough knowledge on matters such as classification, valuation of goods, standards, intellectual property etc.

Paying refunds on time

Refunds division is said to be the slowest moving unit in the Department. Typically it takes several years to secure a refund. It is suggested that the law provide for some relief measure if a claim is not paid within, at least 6 months after submission

Gold Card System

Allowing for mutual recognition of authorized traders from one country to another would lead directly to more predictability, reduced risk, less opportunity for theft and pilferage in the supply chain and increased opportunities for facilitation of businesses and contribute towards enhanced security standards. Hence the proposal to introduce a gold card system, which would facilitate trade and provide incentives for good compliance by providing a "fast track" clearance procedure for lower risk importers, is timely. According to the proposed program the pilot project is to be launched in July 2003.

Uniform Coding System to be used by all institutes

The Customs is using a HS coding system, which is internationally accepted and is regularly updated with new additions. Other local institutes such as Sri Lanka Standard Institute (SLSI), Import Control Department and Department of Pesticides have coded and gazetted the products that come for inspection to their departments. However there are apparently instances where these codes are not in conformity with standard HS codes and in addition the codes are not updated to accommodate new revisions. This creates unnecessary problems for importers. The other institutes still use the descriptive method to classify products.

Geographical location of institutes administering trade

Since the various government agencies overlooking different aspects of trade transactions are not in proximity to Colombo and since they are not electronically linked, it takes a long time to process relevant documents required for the clearance of cargo (e.g. Dept. of Pesticides is in Kandy)

Clarification of functions and lines of authority

The functions and responsibilities of the officers at Customs starting from Director General of Customs are not implemented with clarity. For example at present the authority vested in the DGC is exercised by all grades of officers even in instances in which the law does not state, "by an officer authorized by DGC". This leads to confusion and encourages corrupt practices.

Working extended hours without overtime

The customs was requested to work around the clock and this has been highlighted as an important element in facilitating trade. The large number of holidays in the country has also become a problem. According to Customs the persons who come to obtain services after about 7 p.m. is negligible. As a result the Customs have discontinued to work after 7 p.m. One possible reason for this is that other institutes involved in the entire process such as banks being close at this time. Another reason given is that all parties have become used to the old system for such a long time, it will take some time to adjust to work around the clock, hence some time should be given for this adjusment.

Establish Effective and Rational Inquiry Procedures

At present inquiry procedures are costly and time consuming. Therefore it has been recommended to set up a system with following features:

- Should be well defined, the law violated must be clearly stated
- Statements must be recorded
- Extract of the proceedings made available to the defendant
- A Board of Commissioners should act as an appellate body
- Avenues of further appeal should be made simple

Clarify Customs Export Procedures

Sri Lanka being a country that depends a great deal on export of goods and services need to put greater emphasis on facilitating exports. It is said that it is much more difficult to export than to import. A number of unnecessary procedures for processing of export cargo remain in place despite the liberalisation of trade and payments and removal of customs duties on exportation.

Capacity Building

A well-designed and targeted capacity building exercise is focused on improving the efficiency and effectiveness of customs administration. Capacity building needs to go beyond a series of narrowly focused activities to embrace a more comprehensive and long-term approach designed to address all areas of Customs administration.

Technical Assistance

World Customs organisation is willing to provide technical assistance and capacity building support. It is up to the Customs administration to take a strategic approach and all stakeholders to commit themselves to the practical implementation of recommended measures. The Sri Lanka Customs needs to approach these international organisations and seek their support.

Large Workforce

SLPA has over the years built up an unnecessarily large workforce due to political appointments made by successive governments. Politics have also played a role in the arrangement of work practices in the port. Downsizing the workforce and managing it at an efficient level on a sustainable basis is a must to enhance efficiency.

Developing Dry Ports

As a result of the space constraints faced by the port, a need has arisen to develop dry ports. These could be used to transfer the cargo straight from the ship to the dry port. This will enable the agents to move freely and to operate more efficiently. Developing dry ports would help to eliminate congestion created by a large number of import and export containers at the entry and exit of the Port.

Expanding Space Available at Port

It is estimated that the Colombo Port would run out of space by 2010 and hence there is a great need to develop additional ports and to expand the existing space at the Colombo port. This has been identified as a priority area for a long time, however no significant progress has been made. The sites identified to be developed are Galle, Oluvil, Hambantota and the Colombo South harbour. There has been many debates over which project should be given priority and as is common in many other areas politics plays a major role in decision making and hence these much needed infrastructure projects get unnecessarily delayed.

Concluding Remarks

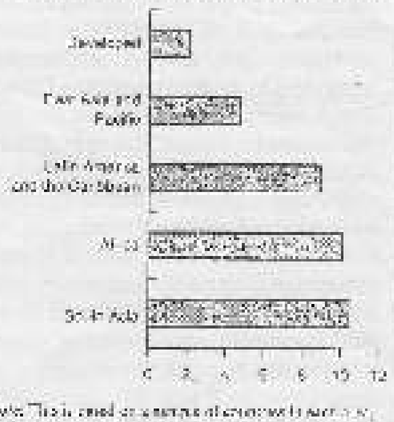
Sri Lanka is a small open developing economy that depends heavily on international trade and foreign direct investments. At the same time, Sri Lanka has great potential to evolve as a shipping and an aviation hub for the region due to its strategic location. In addition, having an efficient trade facilitation system in place would contribute significantly to attract potential and foreign direct investments.

However it is important to remember that "one size fits all" solutions simply do not work. The problems faced by each country are unique to that particular country and needs country specific solutions. The solution is important to also note that by the local stakeholders in the country to come up with practical, innovative solutions with a long-term vision.

There is wide consensus that trade facilitation must be approached in a coordinated manner to ensure that problems are not created in one part of the transaction chain by introducing solutions to another part. This requires an effective forum where private sector managers, public sector administrators and policy makers can work together towards the effective implementation of jointly agreed facilitation measures. This forum should consist of all parties engaged in international trade: manufacturers, traders, exporters, freight forwarders, shipping lines, insurance companies and public administrators. Recently some attempts have been made to consult all parties concerned in accepting and establishing procedures. However there are complaints that although they have been called to participate, their ideas and suggestions are not being incorporated or given due recognition. There is a feeling that despite appointing committees and developing proposals, these are not being taken into consideration when implementing the projects since the final decisions lie in the hands of the politicians.

Clearing customs takes longer in developing countries

Average number of days to clear customs for sea cargo



Note: This is based on a sample of countries [illegible]
see Figure [illegible] in chapter 5.
Source: [illegible]

Trade facilitation involves a large number of Ministries and government departments, hence coordination of these institutes is very important to establish a seamless process. Lack of coordination and commitment and vested interests are major barriers that have to be solved. Creation of trade facilitation conducive environment [illegible] needed for [illegible].

Lack of sufficient resources has been cited as the major barrier for Customs in becoming an efficient trade facilitation body. This is a common complaint made by all developing countries, but how long can we afford to postpone vital reforms required to accommodate [illegible] the process? Apart from funds, there is lack of initiative, focus and commitment to do the right thing. Trade facilitation cannot be improved by the effort of one individual or one institute; this is a joint effort, however actions and attitudes of one individual or one institute can block the progress of the whole process.

In order to reap the benefits of automation and modernisation, at the moment the traders pay Rs. 250 [illegible] as computer fee and once EDI [illegible] it is proposed to charge US $ [illegible] as transaction fee out of which about [illegible] percent is expected to be received by the Ministry of Commerce and the balance goes to the service provider. It is understood that in addition there is a proposal to introduce a US$ 10 as "Customs modernisation fee" [illegible] would be an additional cost to importers and exporters and the general feeling is that the cost is too high. However in the long run the processes reforms help to reduce corruption and increase efficiency, the gains may well be higher than costs. All depends on how well the reforms are being carried out and to what extent these reforms help to achieve the objectives. Further to enhance the transparency and accountability the customs needs to spell out clearly how the funds would be utilised and the private sector should be involved in the management of the Fund. At the same time the Customs should give an update regularly on the financial position of the fund to the trade and industry that contributes to the fund.

Trade facilitation is a less controversial area compared to trade liberalisation. Besides, estimates prove the benefits of improved trade facilitation could be far greater than the benefits of trade liberalisation. There is more support from the private sector towards this initiative whereas the cooperation of the public sector is relatively low. In a highly competitive globalised environment, any measure that would help to enhance the competitiveness of domestic industries in the international market should not be ignored. Trade facilitation is an important element that would greatly reduce costs of trade, which in turn would give a competitive edge over others in the international market. This is an area, which has been neglected for a long time. It is imperative that we give more priority to trade facilitation, and it is a must if we are to achieve the set medium term growth target of 10 percent and to become a shipping and aviation hub for the region.

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Interviewed

Mr. Ravindra Ratnapala, Chairman, The Sri Lanka Shippers Council

Mr. M S M Niyas, Chairman, Association of Clearing and Forwarding Agents

Mr. Romesh David, Immediate Past Chairman, The Sri Lanka Freight Forwarders Association

Footnotes

[1] Asia Pacific Economic Cooperation

[2] United Nations Center for the Facilitation of Procedures and Practices for Administration, Commerce and Transport

[3] World Customs Organization

[4] To find out more about the proposed project in Sri Lanka, visit the website www.eserviceslanka.com

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Conclusion

Concluding remarks on effects of international trade and economic growth in Sri Lankan economy could summarize as follows:

Growth: The major structural change of economy is the reduction of share of agriculture in GNP and expansion of the share of manufacturing and services in GDP. The composition of agricultural exports has reduced from 70% in 1977 to 19 in 2001 while shares of industrial and petroleum exports has increased from 15 % in 1977 to 77 in 2001 respectively (Central Bank of Sri Lanka, 2001). However, importance of agriculture sector still remains, providing employment to more than 40 percent of labour force and 19 percent of export earnings. The GNP per capita income of the country has increased from US$ 176 in 1978 to US$ 881 in 2000, becoming a country of middle-income economies as categorized by the World Bank (*see* **Table 1**). Though the economy has changed very fast in past two decades, the agricultural sector and paddy sector growth rates increased very slowly and some instances negatively, indicating more likely the neutral growth or anti trade biased growth. However, it is clear that overall effect of economic development is not merely depending on agricultural sector. When the effects of other sectors (service and industries) are very effective, influence of agricultural sector could be minimized.

Production and Consumption: As indicated in **Fig.3** and **Table 4**, production and consumption major food items like paddy and wheat has increased over the period indicating increase of consumer welfare and food security.

Table 4: Domestic Production, Consumption and Welfare

Item	1990/95	1999/2000
Quantity of Imported Rice	136	209
Quantity of Imported Wheat	775	873
Domestic Rice production	1672	1676
Consumed total grains	2583	2758
Domestic rice production as a % of total consumption	64.7	60.8

Source: Daily Mirror (2001.11.15)

Table 5: GNP and Growth Rates of Agricultural Sector and Paddy Production

Year	Growth Rate		
	Agricultural Sector	Paddy	GDP
1983	5.3		4.9
1984	2.0	15.2	5.1
1985	9.9	-2.4	4.9
1986	2.2	10.0	4.3
1987	-8.1	-2.5	1.5
1988	3.3	-18.0	2.7
1989	-1.9	16.4	2.3
1990	10.4	16.7	6.2
1991	0.8	21.3	4.6
1992	2.4	-5.9	4.3
1993	5.0	-2.0	6.0
1994	3.8	9.6	5.6
1995	3.3	4.7	5.5
1996	-5.1	4.7	3.8
1997	3.0	-26.7	6.4
1998	2.5	8.6	4.7
1999	4.5	Na	4.3
2000	1.8	Na	6.0

Source: Central Bank of Sri Lanka and Data Bank,HARTI.

Factor Mobility: The labour, main production factor which enjoyed comparative advantage in the country both in terms of skilled and unskilled labour, has moved from agricultural sector to industrial and service sectors. As a consequence labour price has increased both in agricultural sector. According to recent statistics, labour rates have increased more than 250% in all agricultural areas, indicating that cost of production of many agricultural commodities also increased at least 40 percent (Henegedara, 2002). This was indirectly affected for the production and consumption of some agricultural crops

Technological Change: As a result of green revolution and research and development activities, the adoption of high yielding varieties increased from 71% in 1972 to 90% in 1997 (Dhanapala, 1997). The effect of wider spread of new technologies was greatly helped to increase the production efficiency and to offset the bad effect of increasing production inputs.

Though non-plantation agriculture indicated some negative effects, there is a possibility to product and market integration through encouraging the processing of tea, coconut and rice sectors (Somaratna, 2002). However, in summary it could be concluded that tariff liberalization foster economic growth by showing a path way in the direction for sustainable development.

Footnotes

2 NPC is the ratio of domestic market price of a given commodity to its border price.
Thus: **NPC** = P^d / P^b where P^d – domestic price of given commodity
P^b – border price of the commodity

3 The EPC is defined as the ratio between the value added in domestic market prices to the value added in world prices for a particular production process.
EPC = V^d / V^b where V^b – value added in border prices
V^d – value added in domestic prices

Assessment of the Performance of the Indo-Sri Lanka Free Trade Agreement (ISFTA)

D.G.A.P. Dharmapriya
Deputy Director, Department of Commerce

The conclusion of the Framework Agreement of the ISFTA in December 1998 at the highest political level and subsequent implementation in March 2000 marked an important milestone in India – Sri Lanka relations and in trade relations, in particular, as it concretized bilateral relations and paved the way for closer economic integration. The bilateral FTA imparted much needed impetus to Sri Lanka in her endeavours to enhance market access for her products in the Indian market.

Consequent to the delayed implementation of the ISFTA in March 2000, divergent views have been expressed on whether the Agreement has produced the expected results.

Macro position of bilateral trade between Sri Lanka & India

As observed from the **Table 2** while imports from India grew from Rs. 53.7 bn. in 2001 to Rs. 79.8 bn., in 2002 by 48.6%. Imports/export ratio increased from 8.6:1 to 4.9:1 and import coverage ratio which acts as the barometer to measure the extent to which export proceedings can cover the disbursement on imports, increased from 1.6% in 2001 to 20.23% in 2002. During the year 2002, value of exports from Sri Lanka recorded a 136% growth on year-on-year basis.

India which stood as the 22nd buyer of Sri Lanka in 1990 accounting for only 1.1% of the value of Sri Lanka's total exports, emerged as the 5th largest buyer accounting for 3.6% of the value of total exports (Rs. 446,353 Mn.). The portion of Sri Lanka's exports absorbed by India (Rs. 16,153 Mn.) is equivalent to 8.6% of value of Sri Lanka's exports to the USA (Rs. 188,596 Mn.), our main export market during the same period.

Performance of preferential exports under the FTA

Value of preferential exports (Rs. 10,930 Mn.) is equivalent to 68% of Sri Lanka's total exports to India amounting to Rs. 16,153 Mn. in 2002 as against 23% in the previous year. It is a clear indication that the rate at which tariff concessions are being utilized by the exporters in Sri Lanka is on the increase.

According to Table 2, value of exports in terms of US$ under the FTA from Sri Lanka to India has risen to US$ 114.3 Mn. in 2002 from US$ 15.5 Mn. in 2001, registering an impressive growth rate of 620% as against 54% in 2001 on year-on-year basis (in the absence of uniformity of the periods under review, monthly averages were used in analyzing the growth dynamics of Sri Lanka's exports to India).

In order to have a realistic assessment of the growth dynamics of preferential exports under the FTA, micro analysis should be performed on the composition of preferential exports in an objective manner. In the light of the detailed statistics of preferential exports at Annex 1, it has been observed that the growth momentum of preferential exports has been propelled by copper related products namely copper ingots, wire bars, billets and copper wire which have collectively accounted for 63% of the value of total preferential exports in 2002 (Rs. 10,930 Mn. or US$ 114.3 Mn.) as against 0% in the year 2001.

Performance of preferential exports under the FTA excluding copper related products

In the light of the Table 4, it has been observed that total preferential exports minus copper related products hereinafter referred to as "other products", have recorded a remarkable growth rate of 192% in the year 2002 when compared with the growth rate of 45% in 2001 in terms of US$.

Waste paper, which appeared as the largest item of exports under the FTA in 2000 accounting for 40% of the total export earnings remained as the major item among non-copper exports, accounting for only 5% of value of exports in the year 2002. It is noteworthy that value of exports of Dual Inline Memory Modules (DIMMs), a part for computers, has increased from Rs. 5.4 Mn. in 2001 to Rs. 493.7 Mn. in 2002 posing an exponential growth rate of 9000%. DIMMs entered the Indian market subsequent to the implementation of the FTA. Furniture, next item featuring prominently among the list of non-copper exports, registered a remarkable upswing in its export earnings from Rs. 45 Mn. in 2001 to Rs. 144 Mn. in 2002 projecting a continuous growth trend even despite discriminatory sales tax imposed in Tamil Nadu state to which bulk of exports of furniture was destined. Similarly, pneumatic tyres with a value addition of more than 50% and with a contribution of 1.3% to the total preferential exports also figure in 2002 appraisal among top ten non-copper exports to India under the FTA.

Basic customs duty reduction commitment as per the FTA

Table 1

No. of Tariff Lines in (in 6 - digit H.S. 1996 Code)

	Sri Lanka's Commitment	India's Commitment
Nil Negative List (Virtual)	1,190	196
50% (Fixed) – Garment Quota	—	338
100% (Zero duty)	310	1,291
50% (Phased out to 100% in 3-years)	888	2,759
50% (Fixed) – Tea Quota	-	5
25% (Fixed) – Textile items	-	523
Up to 100% in 8 – years	2,724	-
Total No. of Tradable Items	5,112	5,112

Macro position of bilateral trade between Sri Lanka & India

Table 2 — Sri Lanka – India Trade

Year	Imports Rs. Mn.	Exports Rs. Mn.	Trade Balance	Import/Export Ratio	Import Coverage
1996	31,055.6	2,255.1	(28,799.5)	14 : 1	7.26%
1997	33,023.5	2,524.3	(30,499.2)	13 : 1	7.64%
1998	35,897.7	2,279.4	(33,618.3)	15.7 : 1	6.35%
1999	36,012.0	3,020.0	(32,993.8)	11 : 1	8.22%
2000	45,477.1	4,217.3	(41,259.8)	11 : 1	9.27%
2001	50,750.0	3,283.7	(47,464.3)	15.6 : 1	6.50%
2002	79,947.1	16,152.9	(63,794.2)	4.9 : 1	20.20%

Source: Sri Lanka Customs

The following items of exports featured prominently among first 20 products of exports under the FTA to India:

Copper products (63%), waste paper (5.3%), Dual inline memory modules (4%), black pepper (3.4%), pine resin (2.5%), lead ingots (2.2%), naphthalene (2.5%), iron scrap (1.7%), copper scrap (1.6%), furniture (1.3%), tyres (1.3%), aluminum scrap (0.9%), high density fibre board (0.9%), energy saving bulbs (0.9%), marble slabs (0.7%), mace (0.6%), tin ingots (0.6%), multi wall paper sacks (0.4%), copper dross (0.44%), palm oil (0.3%) and Samahan (0.3%).

Table 3

Year	Rs. Mn.	US$ Mn.	Monthly average US $ Mn.	Growth in monthly average % US$
2000 (March-Dec.)	655.11	8.60	0.86 (8.6/10)	-
2001	1,422.5	155	1.32 (15.9/12)	53.5
2002	10,929.9	114.3	9.5 (114.9/12)	620.0

Source: Certificates of Origin issued by Department of Commerce

In the light of the **Table 5** it has been observed that the first ten products have accounted for 85% and the first 20 products have accounted for 94% of the total value of preferential exports, depicting a high degree of concentration on a few products.

Utilization of quota for readymade garments and tea

As in the previous years, utilization of quota for tea (15 Mn. Kgs.) and readymade garments (8 Mn. pieces in 2002) remained at a dismal level of below 1% of quotas available. Lack of marketing efforts, pre-occupation with traditional markets, absence of brand names etc. remained as main reasons for under utilization of quota on ready-made garments, whereas inadequate marketing efforts, uncompetitive prices etc. were considered as main reasons for poor performance in the utilization of tea quota.

New products exported to India subsequent to the implementation of the FTA

It is encouraging to note that a number of new products have entered the Indian market consequent to the implementation of FTA.

The aggregate value of exports of new products under the FTA has dramatically increased from US $. 6.5 Mn. in 2001 to US $. 43.4 Mn. in 2002 recording an exponential growth rate of more than 500% on – year – on – year basis. The products which contributed to such a growth include copper ingots, wire-bars and billets (Sr. No. 41) tyres (Sr. No. 21), H.D. fibre board (Sr. No. 23), furniture (Sr. No. 57) of **Annex III**, a list of new products. It can be seen that new products such as multiwall paper sacks, marble slabs, ceramicware, jewellery, ice cream machine, furniture etc. have shown a sustainable export capability during the period under review whereas export items such as soft drinks, polyester spun yarn, gloves, saneepa slippers, sandles, fibre products, measuring devices, safes, lighting fixtures, prefabricated buildings (roof), etc. which entered into the Indian market in 2000 and 2001 consequent to the implementation of FTA could not be sustained in the year 2002.

FDI and Employment

As a result of the FTA with India, according to the estimates of the Board of Investment of Sri Lanka, about 40 investors (majority of them Indian nationals) have invested in Sri Lanka to the tune of US$ 30 million creating about 1200 employment opportunities, mainly in rural areas.

Composition of preferential exports

It has been observed that the Indo – Sri Lanka Free Trade Agreement has played a key role in enhancing appreciably the quantum of exports, both in terms of volume and value from Sri Lanka to India. However, it has also been observed that the bulk of preferential exports under the FTA is not for direct final consumption and can be considered as intermediate products which are required by the Indian industries. It has also been observed that the domestic value addition of as much as 80% of the preferential export ranges between 35% - 40% of the FOB value. Companies owned by Indian nationals are accountable for about 80% of the preferential exports.

Tariff reduction commitment in post March 2003 period

In the light of the **Table 7**, import duties applicable on 4,150 tariff lines are duty free now, under the FTA.

Import from Sri Lanka

India has emerged as one of Sri Lanka's main suppliers in the recent past, even prior to the implementation of the FTA and particularly during the last decade. India gradually emerged more as a supplier to Sri Lanka than a market for Sri Lanka's export products. The emergence of India culminated in the last few years by becoming the main supplier to Sri Lanka accounting for about 13% of the value of the Sri Lanka's total imports. The import pattern of Sri Lanka in the recent years, suggests that Indian imports will continue to increase substantially in the years to come since India is in a position to replace other suppliers to Sri Lanka with the advantage of concessions under the FTA. However, these imports are coming on the basis of "need to source from out side" and India fitting into the need. It is inevitable that due to the FTA, some of the products of Indian origin which would have been non-competitive otherwise, may enter the Sri Lanka market.

Direction of Sri Lanka's trade has distinct characteristic features. Her main suppliers such as India, Japan, Hong Kong, Taiwan, Singapore, etc. are in the East whereas her major buyers or markets such as USA, EU etc. are in the West. Sri Lanka's major suppliers are not necessarily Sri Lanka's major buyers, except

Table 4

	2000 (March – Dec.)	2001	2002
Exports under FTA	634	1,423	10,930
Less			
Copper products	-	146	6885
Other Exports	634	1277	4085
Exchange rate	75.78	89.36	95.66
Other exports US $ Mn.	8.4	14.3	42.7
Monthly average US $ Mn.	0.84	1.2	3.5
Growth in monthly averages of other exports	-	43%	192%

Other exports = Total exports – Copper related products

Source: Certificates of Origin issued by Department of Commerce

Table 5

Degree of concentration of exports in terms of value	% to total preferential exports
(1) First Product (copper products)	63
(2) First ten products	85
(3) First twenty products	94
(4) All (94) products	100

Table 6

Year	Rs.Mn.	U.S. $. Mn.
2000 (March – Dec.)	93.2	1.3
2001	583.7	6.5
2002	4167.9*	43.4

Source: Certificates of Origin issued by Department of Commerce

* Including exports of vanaspati (Rs. 3425.0 Mn) which was recorded only in the year 2002, during the period under review.

Japan, resulting in favourable balances with the countries in the West and unfavourable balances with the countries in East. As mentioned earlier in this report, India emerged more as a supplier to Sri Lanka in terms of consumer, intermediate and capital goods and therefore, an unfavourable trade balance with India is inevitable in the macro context.

The other factor which causes a trade balance heavily in favour of India is the asymmetries of economies in terms of export base, excess capacity, raw material supply base, degree of industrialization, lower freight charges, availability of skilled manpower etc.

Today in the global context, bilateral trade balances is a crude indicator in measuring strengths and weaknesses of an economy. As long as overall trade balance is at a sustainable level, a huge term unfavourable bilateral trade balance with a single country may not be a matter of grave concern.

Issues arising in the implementation of FTA

There is a perception among certain quarters that there are many problems in implementing the FTA. The Department of Commerce being the focal point in Sri Lanka for the ISLFTA, which is the issuing authority for certificates of origin, is the first authority to know if Sri Lankan exporters face any problems on the FTA. The Department of Commerce gets to know the issue even before the Indian Government is aware of it. Certain problems which arose during the first year of implementation were teething problems, and would arise in implementation of similar agreements with any country. A recent study concluded by the UNCTAD noted that "policy barriers" is one of the main reasons for lower South – South Trade. This applies to Indo-Lanka FTA too, where initial implementation issues were blown out of proportion creating an impression that such problems have negated the benefits of the FTA. It has been observed that even in the developed countries, particularly in the post Uruguay Round era, there was a tendency to erect non-tariff barriers when import duties (tariff barriers) were reduced or eliminated. Viewed in this context, India cannot be an exception to the general trend.

During the period March 2000 to end 2002, Sri Lanka has effected 4600 shipments to India under the FTA, of which less than 50 consignments were subjected to significant delays at the point of clearance due to reasons such as customs valuation, application of TBT (Technical Barriers to Trade) and SPS (Sanitary and phyto-sanitary standards), non availability of specimen signatures of authorized officers of Sri Lanka at certain customs entry points in India etc. Violation of the principle of National Treatment (discriminatory sales tax in Tamil Nadu) was also observed. Most of the delays in clearance of export shipments were of non-trade like nature due to the effective intervention of the Trade Offices stationed in Mumbai and Chennai.

Majority of such delays cannot be construed and interpreted as major obstacles in implementing the present FTA. Such delays mainly occur during the first years of operation due to lack of awareness and experience in implementing a FTA. The recurrence of such issues has already reduced to a larger extent with the passage of time.

It must also be kept in mind that Sri Lanka's export base was mostly geared to cater to developed country markets and most, if not all exporters were pre-occupied with the vagaries of such markets and not much attention had been paid to market access opportunities created in the Indian market through the FTA. Although India is our closest neighbour, the Indian market for a large number of our exporters is a relatively new and untapped market and knowledge of how to do business with India appears to be lacking among our private sector.

Under such considerations, the mere existence of tariff concessions by itself does not beget enhanced volumes of exports. Further, exaggeration of the implementation problems our exporters faced during the first year of implementation may have also created a 'dampening' effect on prospective exporters to India.

It must also be noted that political economy dimensions of India's foreign trade policy management cannot simply be overlooked in any analysis or research on the ISFTA.

Proposals to enhance bilateral preferential exports under the FTA

(a) *Recognition by India of the conformity assessment procedures of the Sri Lanka Standards Institution (SLSI)*

In line with the item No. 10 of the minutes of the meeting at Commerce / Finance Secretaries' level held in New Delhi in February 2000, a MOU has already been signed between SLSI and Export Inspection Council (EIC) of India recognizing conformity assessment procedures of EIC in respect of products which are subject to the Compulsory Import Inspection Scheme in Sri Lanka being implemented by SLSI. Sri Lanka's proposal for a similar MOU between SLSI and the Bureau of Indian Standards (BIS) has not yet been agreed to by the Indian side.

(b) Rules of Origin (ROO)

According to the Rules of Origin Criteria of the ISFTA, "originating status" is conferred on a product only if it complies with the following criteria. Only originating products are eligible for preferential concessions under the FTA.

(i) The product is wholly produced or obtained in the territory of Sri Lanka.

(ii) Where a product is not wholly produced or obtained in the territory of Sri Lanka, the said product should comply with requirements governing sufficient transformation or sufficient working or processing which are defined as follows:

(i) Value of the imported input should not exceed 65% of the FOB value of the finished product, and

(ii) Conversion of HS Nos. between non-originating input and the finished product should take place at 4 digits H.S. Code level,

(iii) The processes involved in transformation should not be minimal processes which are considered as insufficient working or processing, even though H.S. Transformation takes place as indicated in (ii) above. In addition, the final process of manufacture should be performed in the territory of Sri Lanka and the consignment should be directly shipped to India.

Tariff reduction commitment in post March 2003 period

Table 7

	Sri Lanka's Commitment	India's Commitment
Nil (Negative List)	1180	[illegible]
50% fixed – Garments		[illegible]
Zero duty	1208	[illegible]
50% - fixed – Tea Cups	-	15
25% - fixed – Textile items	-	528
35% increased to 100% in 8 years	2724	-
	5112	5112

(iv) In the case of Cumulative Rules of Origin where inputs are sourced from India, the domestic value addition in Sri Lanka should be at least 25% of the FOB value of the finished product where as the aggregate value addition should not be less than 35% of the FOB price.

If a product being manufactured utilizing imported inputs should satisfy the above Rules of Origin Criteria in order for such product to obtain the originating status.

In the course of implementation of the FTA certain industrialists were of the view that the Rules of Origin Criteria are too rigid to be complied with considering the narrow raw material base and the degree of industrialization in Sri Lanka.

Therefore, the following is proposed to inject a degree of flexibility to the ROO:

* Doing away with the requirement of conversion of HS Nos. at 4 digit level where the Domestic Value Addition (DVA) exceeds **40%** of the FOB of the finished product.

A similar approach has been adopted by the MERCUSOR countries. It has been observed that no FTAA or RTAA other than the Indo – Sri Lanka Free Trade Agreement and Indo – Nepal Free Trade Agreement apply **across – the-board**, conversion of HS requirement between non-originating inputs and the finished product at 4-digit level.

In granting originating status for a product, the percentage value addition requirement should take precedence over the requirement of HS conversion. e.g. Where DVA is 50% of the FOB value, it is meaningless to check whether the conversion of HS Nos. between non-originating inputs and the finished product has taken place.

Even in the case of NAFTA Rules of Origin, requirements for conversion of HS code have been designed, more or less, for each and every tariff line or a group of tariff lines. In some cases, conversion of HS Nos. should take place at 6-digit level. As mentioned earlier, MERCUSOR has adopted a higher percentage DVA where conversion of HS Nos. at 4-digit level does not take place between non-originating inputs and the finished product. Most importantly, due to the application of General Rule 2 (a) of the Harmonized System in certain instances, H.S. Conversion does not take place between non-originating parts and the finished product.

Secondly, it is also suggested to apply de-minimums where CIF value of a non-originating input is less than 7% of the FOB value of the finished product, the requirement of conversion of HS Nos. between such non-originating inputs and the finished product should be dispensed with.

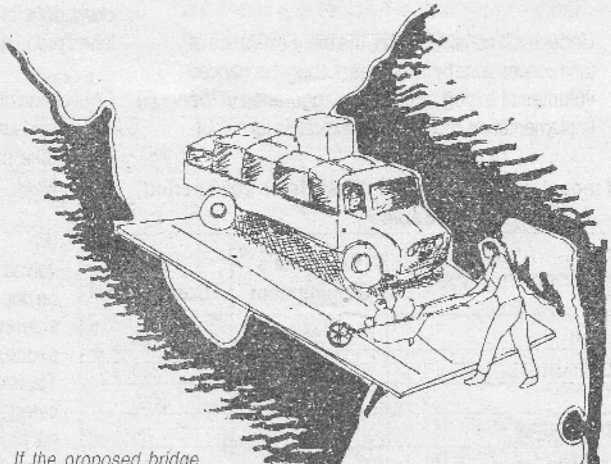
Thirdly, in order to encourage exporters to source inputs from each other wherever possible, when a contracting party has imported inputs from the other contracting party such inputs should be considered as originating inputs in the exporting contracting party and hence the requirement of conversion of HS Nos. should be dispensed with.

At present even if the imported content of a product of Sri Lankan origin is minimal i.e. 5% - 7% of FOB, the product is not eligible for tariff concessions in India though the Domestic Value Addition is 35% or higher of the FOB if the conversion of HS Nos. at 4 digit level does not take place between imported input and finished product.

Fourthly, where input originating in the importing country is incorporated in a product originating in the exporting country, suggest that the importing country should levy import duty only on the value added component.

Issues at Policy Level remaining to be resolved

A sales tax of 11.5% is levied on locally manufactured items whereas like products of foreign origin including that of Sri Lanka are subject to 21%. This discriminatory sales tax is a violation of Article V (National Treatment) of the FTA and has led to an impairment of negotiated concessions on the basic customs duties.



If the proposed bridge across the Palk Straits is built - the bilateral trade under ISFTA will improve tremendously.

Measures proposed to further maximize benefits under the ISFTA

The main thrust of reaping maximum benefits out of market access opportunities created by ISFTA hinges upon the degree of enthusiasm and involvement of the private sector, since the flow of actual exports is really driven by them. Therefore, any proposed measures should be private sector – centered with effective and sufficient support of the government machinery at appropriate stages.

1. It is suggested that a study be undertaken to identify whether major exporting firms of Sri Lanka are in fact exploiting market access opportunities created by the ISFTA.

* If not, reasons for lack of enthusiasm should be identified and however, they should be effectively encouraged to exploit opportunities.

As noted earlier, if existing Sri Lankan exporters remain unenthusiastic about the ISFTA, a fundamental question arises as to how Sri Lanka's objectives in terms of export earnings, employment creation etc. can be achieved.

* If yes, the existing exporter should be strongly encouraged to achieve at least 30% growth in terms of export earnings in US $ on year-on-year basis over a period of next 5 years. I reiterate that, the private sector as "the engine of growth" should necessarily have to take initiatives and play the major role with public sector facilitation in the export promotion drive.

2. Attracting foreign investors to Sri Lanka for export oriented ventures with an emphasis on Indian market.

It is suggested that a study be undertaken by the BOI with the objective of identifying exactly what new products can be manufactured in Sri Lanka based on **comparative advantages,** aiming at foreign markets with an emphasis on the Indian market, and accordingly, an aggressive investment promotion campaign should be undertaken to attract both foreign and local investors for export oriented business undertakings, manufacturing such products.

3. A study should be undertaken to identify Indian investors with buy back arrangements.

4. A study should be undertaken to identify products which can be jointly manufactured in India and Sri Lanka and marketing them in third countries' markets.

Contd. on Page 33

Changing Food Consumption Patterns and its Implications on Agribusiness in Sri Lanka

Dr. Anoma Ariyawardana*

&

Prof. V.N. Nithiyanandan**

Changes in food consumption patterns in any given country are an important indicator of developmental changes. Such changes are mostly an outcome of increased income, and they have implications for the agribusiness sector especially in terms of production, processing and trade. The objective of this paper is to precisely analyze changes in food consumption patterns of Sri Lanka and indicate how they would influence the progress of the country's agribusiness sector. Data show a declining ratio in cereal-protein/total-protein, increase in meat-protein, and animal-protein ratios. Consequently, there is potential for a higher demand for processed, ready-to-eat meals, or food types that can be easily prepared. Sri Lankan agribusiness needs flexibility to accommodate such changing consumption patterns.

Introduction

Food consumption patterns in any country are generally considered to be an important indicator of developmental changes. The historical pattern in food consumption related to a given stage of development, notwithstanding other changes unique to a particular country, has found to be very similar. Sri Lanka (SL) is no exception to this general trend. This study proposes to analyze food consumption patterns in SL during the period 1970-1999 and assess their implications for the agribusiness sector in the country. The required data for the study have been obtained from Food Balance Sheets for the period under review, published by the Department of Census and Statistics of SL.

Though SL is basically an agricultural economy, it is a truism that during the post-independence developmental era, the local production of food had been insufficient to meet domestic demand. Large quantities of food have annually been imported making SL a net food importing country. Apart from the legacies of a general neglect of the food-producing sector during colonial times, another reason behind such large scale imports had been the concern the ruling governments had over escalating food prices and the ensuing rise in the cost of living with political overtones. Items like rice, potatoes, and onions have been imported during off-peak periods mainly to arrest higher prices in the market. In addition to these basic commodities, other items imported includes wheat flour, sugar, red lentils, dried milk powder, fish types etc. The entire wheat flour and lentil requirements are imported. Although some sugar is manufactured locally, it is only a minor fraction of the total needs and nearly 80% of the sugar requirements is obtained through imports. Tinned milk powder (whole dried) is the other heavy importing item. The domestic milk production is very limited and it is capable of meeting only around 20% to 25% of the country's requirement of milk and milk products. Further around 70% of dried and salted fish and the entire quantity of tinned fish are imported into the country. In addition, small quantities of meat types, margarine, and fruits are also imported. The consumer demand for food is an important stimulant in making production decisions. A proper identification of food consumption patterns can therefore be a useful guide in improving the local agribusiness sector.

Theoretical Aspects of Food Consumption

A general tendency observed in development has been that while per capita income and urbanization increase, population growth rates exhibit a decreasing trend. Food consumption patterns are highly influenced by all those indicators. Rising per capita incomes as well as increasing urbanization change the nature of food demanded. Whereas population growth, in terms of people's numbers and age-sex structure, affects food quantity and quality. Other demographic characteristics like aging of the population and the proportion of immigrants can also be correlated to changes in food consumption.

Engel and Bennett have individually put forward significant theories regarding the relationship between patterns of income and changes in per capita food consumption. The Engel's law states that the proportion of the family budget devoted to food declines as income increases, implying that the income elasticity of demand for food is less than one. Whereas Bennett's law posits that the staple ratio (the proportion of calories an individual derives from staples) declines with rising incomes (Mitchell et al., 1997).

Moreover, as income rises consumers desire variety in diet and quality in food, making non-staples more important. At higher income levels, taste and health characteristics too play an important role in consumption decisions. Another feature is that there is a general rise in demand for food that requires less preparation time.

In addition to the above, mention can also be made of the analysis undertaken by the McKinsey School where an attempt was made to relate changes in food consumption to development (Taylor & Findlay, 1995). Its emphasis has been on two distinct relationships to increasing growth in GDP per capita. While the first deals with growth in per capita food consumption, the other considers possible dietary changes.

On the growth in per capita food consumption, two interactions could be mentioned. First and foremost, the priority is for nutritional needs. Then, convenience, health and image become important. Although there is within these changes an inclination for the richer to spend more money on food, no additional expenditure is usually absorbed by packaging and presentation than by the actual content. Dietary changes can also be divided into two kinds. On the one hand, the nutritional balance in food consumption is subject to change. The emphasis is now more on animal protein with a high content of fat, oils and sugar. There is also a high demand for more processed foods. The other change relates to food habits. A Western orientation especially in fast-food eating habits is increasingly noticeable creating a demand for such food products. With growth in living standards of living there is more acceptance of Western eating ways.

Urbanization influences the pattern of food consumption in several ways. Changes in earnings, life style, and shopping facilities are but a few of those which could be mentioned (Rae, 1998). Advertising is a key component of the urban way of life. The processed food market owes very much to advertising in terms of reaching the consumers. An obvious outcome tends to be a consumption pattern with less of staples and more of processed items. In the Asian context this has reflected in higher income urban consumers showing a preference for substituting rice with other food items. The rural consumers however tend to retain a diet with a higher proportion of staples. This trend is also observable among the poorer sections of the urban dwellers - the blue-collar workers and the large number occupying the informal sector. Thus, a relationship between the occupational pattern and the level of staple food consumption can be established (Rocis, 1991, 522). When the occupational structure requires a greater amount of energy it results in higher consumption of staples than any other form.

Mitchell et al. (1997) have identified three broad stages in the transformation process of diets:

* Department of Agricultural Economics, Faculty of Agriculture, University of Peradeniya, Peradeniya.
** Department of Commerce, Massey University, Albany Campus, Auckland, New Zealand.

during the first stage, wherever cereals and starchy roots combine to form the staples, the consumption of cereals increases at the expense of root crops. In stage two, when increases in incomes are registered, the cereal consumption moves toward its peak, while root crops continue to decline. But, on the other hand, non-traditional food consumption expands. The intake of cereals during this stage is either stable or subject to only a marginal increase, whereas, the consumption of livestock items and other products rapidly increases. Moving on to stage three, while a decline in the per capita intake of cereals is observed, livestock products continue to register an increase. To these three, Rae (1995) has added a fourth stage where health concerns influence a shift away from at least some livestock products towards substituting them with cereal-based items.

Gender studies reveal a further factor determining food consumption patterns. It relates to the opportunity cost of time for women (Senauer et al., 1986). When more women come forward to join the workforce, the nature of demand for household food commodities undergoes a change. The compulsion is more for convenience foods with varying degrees of processing at the expense of raw unprocessed items.

Consumption Pattern of Cereals

SL is multiethnic in character consisting of not only different races but also many religions. Each socio-religious group has certain unique food habits. Yet, there is an outstanding element that is common to all. It is the consumption of rice as the staple diet. Rice is always taken as the base food with other food items such as vegetables, fish or meat, which are cooked into a curry. A combination of these items determines the food consumption pattern of SL.

Rice is the primary source of carbohydrate providing the necessary calories. In 1970, per capita consumption of rice was estimated to be 109.84 kg per year, yielding 1,080.34 calories per day. This accounted for 45.57% of the calorie intake. After nearly three decades, in 1999, despite the increase in population from about 12-19 million, per capita consumption of rice has declined to 100.2 kg per year, clearly reflecting a change in the pattern of consumption of the commodity. The amount of calories coming out of rice too has declined to 948.10 per day, which accounts for 40.65% of the daily calorie intake. The change has mainly been caused by a shift from rice to wheat. Wheat flour has gradually become

Reduction of wheat flour based food and increase of rice based foods is one necessary condition for the country's self sufficiency.

the most predominant among cereal food items. A major contributory factor has been the ease with which wheat preparations, compared to rice, could be made. Another reason has been the cheapness of the commodity. But it is an item that is entirely imported. Import figures are a clear indication of its popularity. In 1970, wheat flour imports amounted to 374,550 Mt but by 1999, imports have increased to 682,520 Mt. **Figure 1** shows the changes in per capita consumption of rice and wheat flour.

The other main cereals consumed in the country are maize, sorghum, and kurakkan and meneri. Production of maize, during the period 1970 to 1999, has dropped from 14,410 Mt to 31,470 Mt. Yet, maize that was not imported in 1970 has shown an annual import level of 125,630 Mt in 1999. The increased usage is mainly due to its popularity as an animal feed, which during the 1970-99 period grew from zero to 89,920 Mt. The rest of the cereals, on the other hand, are entirely used for human consumption. During the period under review, production of other cereals has declined significantly. During the pre-1977 period consumption of kurakkan and meneri has gone up significantly and it could be due mainly to the lack of availability of complementary food types during that period. However, along with the liberalization level of consumption has gone down. By overall, kurakkan and meneri along with other grains showed a combined drop in per capita consumption during the period 1970-99 where the per capita consumption levels have dropped from 0.94-0.22 and 0.24-0.01 respectively. **Figure 2** shows the per capita consumption of maize, sorghum, and kurakkan and meneri over the period 1970 to 1999.

A definite conclusion emerging from the pattern of changes in the consumption of these cereals is that they have, during the period under consideration, become substandard commodities. They have over the years been replaced mainly by wheat and also, to a certain extent, by rice. Longer preparation time involved may be one reason for the constant lower demand for the product leading to a decline in production levels. Yet, it is difficult to conclude whether their inferior status is a direct outcome of development in the country. The major reason seems to be the induction of wheat and its consumer attraction in terms of usage and economy. The curtailed use could perhaps be due to a combination of both development and substitution.

Consumption Pattern of Roots and Tubers

Potato, manioc, yams, and sweet potato are the most common varieties of roots and tubers used for consumption in SL. Except for potato, the demand for others are generally met from supplies within the country. Even with potato there is now a conscious effort to fulfill the entire need through domestic production. Nevertheless, lower production levels during certain periods have led to imports. In 1970, local potato production was around 31,740 Mt, which has, by 1999, decreased to 27,170 Mt. During the same period, potato imports have increased from zero to 128,860 Mt. Significantly raised imports clearly indicate that there has been a positive increase in per capita potato consumption where the consumption levels have shot up from 1.88 Kg per year in 1970 to 7.15 Kg per year in 1999. Yet, in some years the increase has been moderate. This may be due to a lower consumption of the commodity during certain periods, caused mainly by policy decisions, which severely curtailed imports. If free market conditions are allowed to prevail, it is possible to use potato consumption as an indicator of developmental changes. A higher use of potatoes can always be linked to an increased standard of living. Nevertheless, one has to be cautious in making hasty conclusions because, like wheat flour, potatoes too

Figure 1: Consumption of Rice and Wheat Flour Per Capita 1970-1999

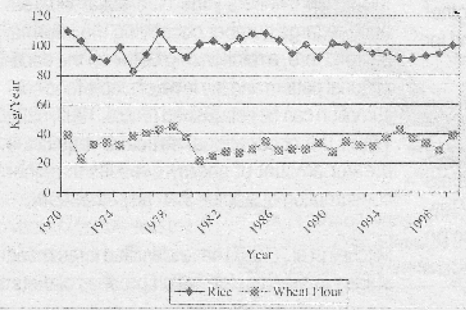
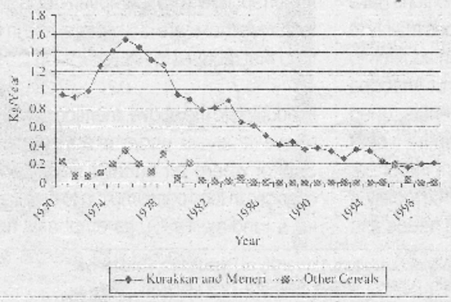


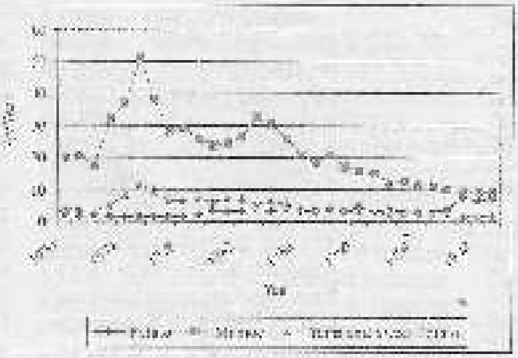
Figure 2: Consumption of Kurakkan, Meneri and other Cereals Per Capita 1970-1999



have the added attraction in terms of food preparation. This would have had the effect of neutralising other factors and increased its usage. Notwithstanding such considerations, its introduction has now eventually placed other roots and tubers of an indigenous variety. Manioc, yams, sweet potato etc. have all been casualties and condemned to an inferior status. Moreover, potato has greatly contributed, along with wheat, towards Westernization of food habits. Consequently, it is in constant demand in the growing fast food outlets located mainly in Colombo and its vicinity.

On the other hand, the production of manioc though still significant, shows a declining trend. In 1970, the production level was 353,750 Mt, which had however, by 1999, almost been decreased to 251,513 Mt. Manioc usually served human consumption but it is not uncommon that in certain years a small proportion went towards animal feed. In 1970, the per capita consumption level was 13.78 Kg and, in 1999, this had declined to 9.25 Kg. Like manioc, yams and sweet potato production has also been reduced. During the period under review, their output levels plummeted from 73,160 Mt to 41,990 Mt. This has resulted in a decreased per capita consumption of 4.04 Kg in 1970 to 1.53 Kg in 1999. Figure 3 shows the changes in per capita consumption of roots and tubers during the period 1970 to 1999.

Figure 3: Consumption of Potato, Manioc and Yams and Sweet Potato Per Capita 1970-1999



The figure shows a sharp declining trend for manioc consumption, and a slightly lesser one for yams and sweet potato. Such reductions in the intake of inferior roots and tubers could perhaps be considered as another indication that the country had climbed a further step in the development ladder. The results are easily comparable with the experience of more advanced countries. Yet, it could be possible, as discussed earlier, the substitution of potatoes for entirely different reasons. It is nevertheless safe to attribute the switch to both enhanced levels of living as well as to superior qualities of the potato in terms of palatability and preparation.

Consumption Pattern of Fruits and Vegetables

Even though SL is the home of a large variety of fruits, a perusal of the total production of fruits during the period under review shows that it has subject to very high fluctuations. For example, the recorded production level of 147,000 Mt in 1970 had dramatically dropped to 45,490 Mt in 1990. Again, in 1999, it rose to 148,390 Mt. During the interim when production was so low fruits had to be imported. Especially, the introduction of fresh imported fruits like apples, oranges in the local market enhanced the consumer demand for fruits. This is clearly evident from the escalated fresh fruit imports from 1,370 Mt in 1991 to 19,330 Mt in 1999. Thus, fruit consumption itself increased from 2.57 Kg to 8.25 Kg between 1991 and 1999. Figure 4 shows the changes in fruit consumption over the period 1970-99.

The internal production of vegetables is entirely sufficient to meet local needs. But, on the other hand, a small proportion, both in fresh and processed forms, could also find an export market. A clear example of the evolving export market had been the Middle East where there was a growing concentration of the SL migrant labour. In 1970, the vegetable production (excepting onions), was estimated to be 799,660 Mt but in 1982 it has nearly halved to 487,300 Mt. However, it has shot up again to 860,850 Mt in 1983 raising the level of consumption. But since 1988 it recorded a sustained decline through to 1999 and reached a level of 660,340 Mt. Within this period of continuous slide, the year 1990 stands out, when production levels during the year dropped sharply from 788,120 Mt in the previous year to 555,820 Mt. The reasons for this decline, discussed below, perhaps be political. But this have had an overall impact on the per capita consumption of vegetables during the period under review.

Figure 4 reveals that per capita consumption of vegetables has risen in 1983 and remained almost alike until 1992. A sharp drop is observed in 1990. Similarly, in fruits a sharp decline could be observed in 1990 and then increased in 1992 and remained constant around the same levels. The reasons for this are not entirely clear. Yet, it could be conjectured that they are more political in nature than economic. The causes beyond doubt could be linked to the prevailed ethnic conflict, and how the Northern and Eastern Provinces that contribute substantially to the total supplies of fruits and vegetables were affected. Acute shortage of supplies led to higher prices which ultimately translated into a drop in consumption levels. In fruits, though the declining consumption was met by imports, the experience could not be reciprocated with regard to vegetables. This difference too is somewhat reflected in the graph. In the post 1990 period, while the consumption of fruits records some increase, the trend is conspicuous by its absence in the case of vegetables.

Consumption Pattern of Meat

Meat consumption in SL, like many other countries of the developing world, is generally affected by religious beliefs. Even within a single religion, there are sometimes differences in the pattern of consumption. The most commonly consumed meat varieties in SL are poultry, mutton, beef and pork. During the period under consideration, both beef and mutton showed little variation in their production patterns, whereas, the production of pork shows a marginal increase. The most marked increase had however been in the production of poultry. It has risen from 2,340 Mt in 1970 to 53,860 Mt in 1999, nearly a twenty-four fold increase. This remarkable rise had in fact been a response to a higher market demand for poultry products, especially chicken. The higher demand is clearly reflected in the consumption figures for the period. The per capita consumption increased from 0.23 Kg in 1970 to 3.09 Kg in 1999. The phenomenal change in the consumption pattern of poultry products is consistent with the experience of developed countries where there is now an increasing trend towards consuming white meat for health reasons. Although the SL increase cannot fully be attributed to such concerns, there is no denial that it could perhaps be one among a few other reasons. A major cause had undoubtedly been more awareness of the nutritional needs of the human body and the contribution animal proteins could make in this respect. The popularity of poultry products, compared to other meat types, is also mainly due to the fact that its consumption is not subject to any religious constraints within the meat-eating population in the country.

The per capita consumption of beef, mutton and pork shows a marginal change during the period under review. Mutton and pork consumption have increased from 0.08 Kg to 0.12 Kg and 0.05 Kg to 0.09 Kg respectively. The Beef consumption on the other hand exhibited a mini-

Figure 4: Consumption of Vegetables and Fruits, Per Capita 1970-1999

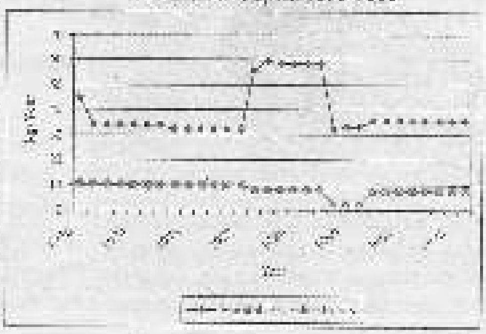
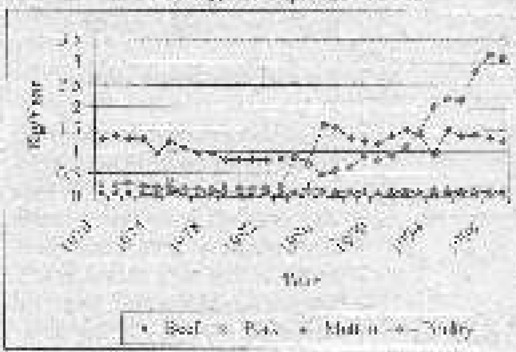


Figure 5: Consumption of Beef, Pork, Mutton and Poultry, Per Capita 1970-1999



mal decrease from 1.28 Kg in 1970 to 1.24 Kg in 1999. The pattern of variation in the per capita consumption of the different meat types is shown in Figure 5.

Common Patterns in Food Consumption

In SL cereal consumption, compared to other foods, is at a higher level. Yet, within this category, while rice consumption displays a declining trend, wheat consumption is subject to sustained increase. The pattern is almost consistent with other high performing Asian countries. Some of the major developing countries like Singapore, Thailand, Malaysia and Indonesia record a declining trend in rice consumption substituted by wheat. In China, though there is no comparable drop in rice intake, consumption of wheat has increased. The substitution of the staple cereal, rice with non-staple cereals such as wheat flour in SL is no doubt compatible with the consumption patterns relating to increased incomes. But unfortunately, other indicators of development, including inflation, have pushed SL to a more backward position. The cereal consumption of course, according to Mitchell et al. (1997) remains almost constant until the country advances to a stage where it is categorized as belonging to the higher income group. SL still with its low-income status, cannot therefore expect much swift change in its cereal consumption. It is reasonable to surmise that the existing pattern would be sustained for a long time without yielding to higher levels of education.

The consumption pattern of roots and tubers is consistent with the development experience of a majority of other countries. As cereals increase as items of importance, there has always been a commensurate decline in the consumption of roots and tubers. This implies, as indicated earlier, a transition from one growth stage to another, which SL has undoubtedly attained.

With the intensification of the development process, the fruit and vegetable consumption too should show an increasing trend. But of the two, vegetable consumption which is a staple of a traditional diet, has displayed a falling trend. This could be, as already mentioned, due to restricted production levels and the absence of any attempts to replenish the deficiency through imports. On the contrary, a newly emerging trend of exporting vegetables was under-lined. This would have no doubt further exacerbated the decline in consumption of vegetables. The fruit consumption, on the other hand, is consistent with the development experience. Although output levels were not very different from vegetables, consumption was maintained at a healthy level through additional imports. Meat consumption is another area governed by the pace of development. It tends to increase with rising income levels. SL meat consumption levels have traditionally been very low. Economies that go through a rapid development process have always shown significant increases in their meat consumption. In SL, while poultry consumption shows a steady rise, increase in the mutton/pork has been more moderate. Beef consumption at the same time shows a declining trend. Apart from the tendencies emanating from the development path, increased health consciousness could be an additional factor influencing these trends. But it needs to be emphasized that more awareness about health is a concomitant of ongoing development. Almost similar patterns of meat consumption, especially with respect to poultry, have been experienced by countries like Thailand, Malaysia, Indonesia and Brazil.

There are three major indicators that determine the changes in food consumption patterns: cereal-calorie ratio, cereal-protein ratio, and livestock-protein ratio. In a normal development path with escalating incomes, cereal-calorie ratio and cereal-protein ratio will decline whereas the livestock-protein ratio will increase. The food consumption data on SL show that cereal-protein ratio and cereal-calorie ratio (within the livestock-protein ratio) have behaved according to expectations (Table 1). During the period under review, the cereal-protein ratio has declined from 50.78% to 50.83% and protein ratio has increased from 1.43% to 5.13% and animal-protein ratio (includes fish, eggs and milk) has increased from 18.41% to 29.02%. Even though, there is an overall marginal decline in the cereal-calorie ratio, intermediary years show a significant decline. This could be attributable to policy changes that have enhanced the consumption of cereals.

It could be mentioned that SL's food consumption patterns demonstrate some similarities with other highly developing countries. The rate of urbanization in SL is relatively stagnant and was estimated to be at around 22%. Consequently, its impact on the food consumption patterns unlike in other countries, may be very low. The per capita income level, a good indicator of living standards, shows that SL has, during the period under review, achieved a higher standard of living. There has been a steady increase in income levels. A higher cost of living however brought about a decline in the real GDP. Any increase in per capita income levels usually leads to enhanced nourishment, which translates itself into raised living standards. It could therefore be concluded that higher per capita incomes have been a major contributory factor towards shifting consumption patterns in SL. Its experience has been no different from other countries in a similar position.

Another conceivable phenomenon along the development path has been the Westernization of the Asian diet. The SL experience is again not very far from what is witnessed in a number of other developing economies. A clear indication of this is the rapidly opening of internationally reputed Western fast food outlets mainly in the urban centers. But, notwithstanding the preference for Western orientation, there could be other reasons too. One of those could perhaps be the need for quickly prepared food to conserve both time and energy. There is also a growing habit of eating out. In addition to the most reputed fast food outlets like the Kentucky Fried Chicken, McDonalds and Pizza Hut, there has been a mushrooming of take-away food shops (both Oriental and Western) in and around Colombo and also in the other major towns. This could in part be interpreted as another symptom of socio-economic progress. It is greatly apart from the acceleration in economic activity, increased participation of women in employment and thus an improvement in their gender status. The demonstration effect created by global exposure through the advancement of modern communications (mass communication or media not excepted) too would have played a role. Tourism too have certainly exacerbated the tendency. Clearly, this is an area that needs further analysis and research.

Table 1 Major Indicators of Sri Lanka's Food Consumption Pattern 1986-1998

	1970	1980	1990	1998
Cereal-calorie ratio (%)	55.51	57.85	55.46	57.95
Cereal-protein ratio (%)	50.78	51.51	50.77	50.83
Vegetable-protein ratio (%)	1.43	1.80	2.61	5.13
Animal-protein ratio (%)	18.41	22.37	24.61	29.02

Conclusion

Changes in the pattern of consumption are an important source that could influence agribusiness planning. At a primary level, before production and import decisions for agricultural commodities are made, the nature of demand for food needs to be carefully analyzed. At the subsequent stage, they have implications for processing of food extending into the agribusiness sector. When incomes increase consumption patterns and consumer attitudes will generally reflect the experience of economies already developed, subject to both religious and socio-cultural norms. A high demand for more processed as well as convenient foods is a usual expectation. Yet, it cannot be fulfilled without the assistance of a viable agribusiness sector. Our study has identified some of the emerging patterns of food consumption in SL. Despite the acute nature of the political problems, the study clearly reveals a range of healthy developments underlining the potential for progress in the agribusiness sector. Cereal consumption could for example occupy a position of priority for some time. Consequently, there will be sufficient opportunity for more initiative and innovation in agribusinesses relating to this pattern. An expanding market for instant preparations like noodles, string-hoppers, hoppers etc. is always a possibility. Increasing level of poultry consumption too provides the potential for variety of businesses that could compete with the more popular fast food outlets through cheaper and quality items. They could also concentrate on preparations more suitable for the local palette.

It is the contention of the authors that the food processing, in contrast to food production, has not received the attention it deserves. Even the little that had occurred is concentrated primarily in Colombo and to a lesser extent in the other major towns. There is a unique absence of uniform national distribution. With increased development, a comprehensive plan of food distribution that includes not only production and import of food commodities, but also food processing is indispensable. Such a processing agenda first and foremost needs to be based on food consumption patterns of people. It could then be tied to the major sectors of the economy: agriculture, industry, and services. Even with regard to exports, there is an urgent necessity for countries to move away from unprocessed, bulk food to more processed and ready-to-use items that could satisfy immediate consumer needs. SL, both as a major exporter of primary (food) commodities and a producer of agricultural commodities for local food consumption, this should be an area of serious concern.

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5. Organizing selling missions to India to promote identified products. Companies like Colombo Dockyard which manufactures high value item such as boats which are eligible for zero duty should undertake such visits.

6. At the First Joint Ministerial Committee Meeting held in July 2002, Sri Lanka gained additional concessions on 51 items of readymade garments. FTZMA garment exporters need to undertake an aggressive marketing campaign in India with the firm resolve of securing more benefits, outweighing the cost of offer. India has given effect to such additional concessions with effect from 12th November 2002.

7. A separate export promotion budget under the FTA should be set up, with a view to defraying certain specific promotion related expenses to be incurred by Small and Medium scale Exporters (SME) to India.

8. Appointment of an Indian consulting group to undertake promotion of Sri Lankan exports and investments arising from the benefits of FTA are of priority. The Indian Line of Credit could be utilized for this. A case in point where an Indian company has been able to sell Sri Lanka among the Indians is the appointment of an Indian company to sell Sri Lanka to the Indian tourists. This has been an importers.

9. There is also a need to create a lobby for Sri Lanka among the industry groups which feel threatened by the competitiveness of Sri Lanka products. Tea, meat products, furniture, biscuits and confectionery are some of such sectors which feel threatened. Indian industrialists who form a powerful sector have access to the political leaders as well as the media may have been responsible for the imposition of sales taxes, implementation of stringent standard requirements etc. The Sri Lankan diplomats based in India should also cultivate the various industry lobbies so that they do not take on Sri Lanka as a competitor. Successful example of such lobbying was apparent with the Clothing and Manufactures Association in Mumbai where the Mumbai garment exporters Association agreed to support the import of garments from Sri Lanka.

   The Sri Lankan Government leaders could also use their friendship with state leaders to persuade them to remove remaining obstacles to the growth of imports from Sri Lanka.

The Ceylon Chamber of Commerce which is the nodal chamber for the FTA should use its influence with the Indian chambers to soften these lobby groups through their counterparts. Exchange of delegations is one such measure while tying up with them as joint venture partners is another such measures. The Ceylon Chambers must use their links with the Indian Chambers to promote the FTA. Informative articles with the support of the CII all in the media and business journals exchange of business delegations, visits to Sri Lanka by top Indian businessmen (Tata, Birla, and Reliance Groups) would also be useful.

Built in limitations against creating import surges in the Indian market

In terms of Article VIII (Safeguard Measures) of the ISFTA, if any product, which is the subject of preferential treatment under this Agreement, is imported into the territory of a Contracting Party in such a manner or in such quantities as to cause or threaten to cause, serious injury to the importing Contracting Party, the importing Contracting Party may, with prior consultations except in critical circumstances, suspend provisionally without discrimination, the preferential treatment accorded under the Agreement.

In view of the safeguard clause and political economy dimensions of India's trade policy management as mentioned earlier in this paper Sri Lanka's export growth pattern under the ISFTA to India should be a gradual and meticulously monitored one.

Conclusion

Possibilities for further maximization of benefits for Sri Lanka, utilizing hitherto untapped market opportunities available under the FTA are immense. The proposed land bridge as well as the ferry service further enhance the potential for trade to develop.

Most importantly, the degree of attractiveness of concessions of FTA with India to promote Sri Lanka as "gateway" to the huge Indian market both for export and investment will not last forever. With the passage of time when India reduces her MFN import duty rates either through future rounds of trade negotiations at multilateral level or through voluntary liberalization, the strategic position of Sri Lanka stands to erode gradually, since the strengths of tariff concessions to drive exports from Sri Lanka and attract investment into Sri Lanka will diminish. Similarly, once India concludes a FTA with ASEAN countries probably by 2010, the strategic position of Sri Lanka will drastically get eroded. Hence, it is of utmost urgency for Sri Lanka to exploit the tariff concessions which are very attractive at present, to establish concrete relations with Indian importers and investors as fast as possible, as this "window of opportunity will not be open forever.

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