Verité insights

Trade in Services: Sri Lanka needs to pull up its socks

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Two previous Verité Insights titled "Sri Lanka missing world's biggest trade party and its in her backyard" & "Trade Agreements that don't deliver the goods" published in May and June 2013 pointed out that Sri Lanka is well behind her Asian neigbours in entering into trade agreements, and that those entered into were also deficient

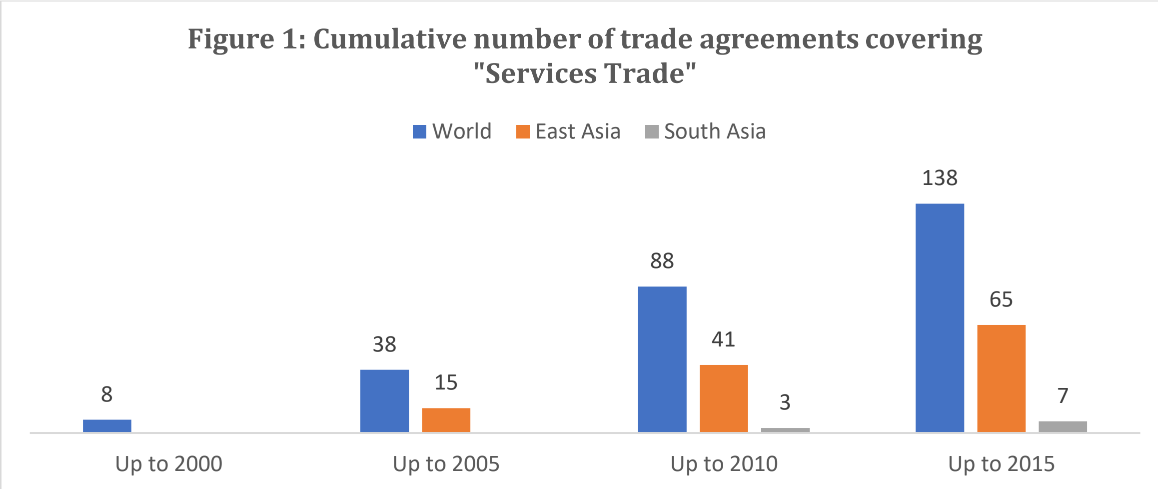
This *Insight* shows that this is even more so the case with agreements that go beyond trade in goods to cover trade in services. This observation does not give a green light to ETCA (Economic and Technical Cooperation Agreement with India). but it does provide some context. Even though ETCA type agreements is 'new territory' for Sri Lanka, many of its neighbors in Asia have been quite vigorous in entering into such goods and services agreements in the last decade.

The current debate on ECTA is around *whether* Sri Lanka should go ahead with the agreement or not. However, the important question to ask is *what* costs and benefits could accrue to Sri Lanka, and how that can be managed by the scope and structure of the agreement. Whether a trade agreement is beneficial or not depends greatly on those details. The experience with existing FTAs suggests that Sri Lankan negotiators need to pull up their socks, and act with greater acumen than in the past to secure benefits.

The trend towards trade in services

Before the turn of the century there were only 8 trade agreements in the world covering trade in services. But the number of agreements have increased exponentially since then. As of February 1 2016 according to the World Trade Organisation (WTO) there are138 trade agreements in the world covering both trade in goods and trade in services. This means that one third of the 419 trade agreements in force today in the world are agreements covering trade in services.

<u>*East-Asia is leading the charge*:</u> It is notable that Asian countries dominate the field in terms of trade agreements. While East-Asian countries are party to 65 agreements, European countries are party to only 30, and North America to only 27. This is most likely because East Asian countries still enter into agreements as individual countries than as a group of countries. For example, ten members of the Association of South East Asian Nations (ASEAN) continue to sign trade pacts as individual countries whereas twenty-eight member nations of the European Union (EU) enter into trade pacts en bloc.



Source: RTA database, World Trade Organisation.

South Asia moves more slowly: South Asian countries have been latecomers compared to East Asia. The members of the South Asian Association for Regional Cooperation (SAARC) entered into an agreement in services in 2010. However, to this date this agreement has not come into force because the countries have not yet finalized the list of service sectors they are willing to liberalize under the agreement.

Pakistan has entered into two service agreements to this date, one with China and one with Malaysia. India, with just 5 agreements in services, is leading the pack. Sri Lanka on the other hand has not entered into a single meaningful trade pact during the last ten years.

India: Look East and Act East: As part of the "Look East" policy adopted by former Prime Minister of India Manmohan Singh to strengthen its diplomatic and economic ties with the Asia-Pacific, the Indian government entered into five major comprehensive agreements during 2005-2015 (Figure 2).

Figure 2: Trade Agreements of India that cover services

Agreement	Year
India – Singapore Comprehensive Economic Cooperation Agreement	2005
India – South Korea Comprehensive Economic Partnership Agreement	2010
India – Malaysia Comprehensive Economic Cooperation Agreement	2011
India – Japan Comprehensive Economic Partnership Agreement	2011
India – ASEAN Agreement (Goods – 2010, Services – 2015) (ASEAN – Association of South East Asian Nations include Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam)	2015

Source: RTA database, World Trade Organisation.

Prime Minister Narendra Modi is re-launching the policy by calling it "Act East" and is keen to further accelerate integration with Asia and the Pacific. As part of this policy, India is in the process of negotiating trade agreements with Indonesia, Thailand, Mauritius, New Zealand, Australia. India is also an active party of the proposed Regional Comprehensive Economic Partnership (RCEP) between India, China, Japan, Australia, South Korea, New Zealand and ten member states of ASEAN.

Trading with Asia

It is important to note that ASEAN countries such as Vietnam and Cambodia, which compete directly with Sri Lanka in the world market, have entered into comprehensive trade agreements covering both goods and services with India and China, and have gained preferential access to these largest and fastest growing markets in Asia.

The traditional markets in the West, such as the European Union and the United States will continue to be major players in world trade. Yet, Sri Lanka is already facing the consequences of having put too many eggs in too few baskets. Stagnating demand from these markets (particularly the EU that is in recession) is contributing to the slowdown in growth of Sri Lanka's exports. It is not contentious to say that Sri Lanka needs a strategy to trade more with Asia.

The devil is in the details

Countries sign trade deals to expand exports to the partner countries of the agreement by reducing barriers to export. Hence, the benefit of a trade agreement depends a great deal on two aspects. First, on what sectors and activities are covered (scope) and second, on the mechanisms by which the agreement handles barriers to trade (structure).

The experience of Sri Lanka with existing goods agreements show that a host of rules within and outside the agreement can work as barriers to trade. Sri Lanka has had a trade agreement with India since 2000. The scope of that agreement is promising. It gave Sri Lanka a competitive edge over imports from other countries especially in food products. However, although tariffs were brought down for processed foods, the agreement had no provisions to tackle non-tariff barriers (NTBs) which continue to hamper trade. As a result, Sri Lankan exporters suffer from NTBs such as cumbersome standards compliance procedures at the point of entry in India, causing delays and adding to costs, negating the tariff advantage. This could have been avoided.

Failing to address NTBs can have huge negative consequences. In Sri Lanka's case, the above NTB could have been avoided by having a Mutual Recognition Agreements (MRA) on conformity assessment procedures. Most trade pacts make MRAs an essential part of the agreement, to reduce compliance related delays and costs. But Sri Lanka failed to ask for it and the two countries are yet to sign a MRA. This is despite Sri Lankan exporters being severely hampered by compliance related NTBs. There are several other examples on how the agreement with India in 2000 was poorly structured by Sri Lankan negotiators.

Therefore, the critical issue is not about *whether* to enter into trade deals like ETCA covering services, but about *what* the scope and structure of the final agreement is (in either goods or services). Ensuring that the agreements have a beneficial **scope**: accessing viable export sectors and reciprocal opening-up with appropriate safeguards; and that they are well **structured**: effectively removing barriers without being hobbled by ancillary rules and requirements; is critical in evaluating the value of ETCA to the country. The devil is really in the details; not in the concept itself.