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India – Sri Lanka : Comprehensive Economic Partnership Agreement

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- **Rationale and Evolution**

The India-Sri Lanka Free Trade Agreement (ILFTA) was signed ten years ago in 1998 and since then economic relations between the two countries have expanded substantially. Sri Lankan exports to India increased 9 times from 1 per cent of overall exports to 9 per cent by 2005. So much so, India became the 3rd largest destination for Sri Lankan exports. The number of products that Sri Lanka exported to India doubled from 505 tariff lines to 1024 tariff lines at HS 6 digit level. The export:import ratio also improved in favour of Sri Lanka. Whilst the absolute trade deficit between the two countries has enlarged, this has been balanced to an extent by flows of Indian investment to Sri Lanka, which have increased markedly so much so that India is now the 4th highest investor in Sri Lanka. At the same time however there have been concerns about the implementation of the agreement and the real economic benefits for Sri Lanka that have arisen from it. Sri Lanka's export growth to India has been largely undiversified. 50% of exports were copper and "vanaspathi" until 2006 – industries in which domestic value addition and employment creation are low and import content is high. Furthermore, certain Sri Lankan firms have had difficulties in setting up businesses or exporting to India. Para-tariffs such as discriminatory state taxes in India have eroded preferences Sri Lankan exporters have obtained at the national level. Port restrictions have limited Sri Lanka's exports of tea and "vanaspathi".

Despite these early teething problems in implementing the FTA, both parties were aware of the importance and benefits of broader economic integration and thus were keen on deepening and widening the FTA by negotiating a Comprehensive Economic Partnership Agreement (CEPA). Negotiations began in February 2005 based on recommendations of a Joint Study Group, set up between the two countries, which recommended an Agreement encompassing trade in services, investment liberalisation and economic cooperation along with a deepening of the FTA by trimming negative lists of both Parties. Thus far thirteen rounds of technical negotiations have been completed – and while Framework Agreements are largely finalised, there remain minor negotiations to take place on the specific schedules.

- **Trade in Services**

This article will focus particularly on the trade in services aspect of the CEPA. Trade in services refers to the commercial exchange of services between countries. It is in essence similar to trade in goods in that it results in greater consumer choice and lower prices, increased competition and dynamism in markets and increased choice in sourcing services for business. However trade in services occurs across 4 modes.

Mode 1 – Cross border services – Where neither the consumer nor supplier of the service leaves their country (for instance, business process outsourcing, telemedicine)

Mode 2 – Consumption abroad – Where the consumer travels to the country of the supplier of services (Travelling abroad to obtain education, health services or tourism)

Mode 3 – Commercial presence – Where the service supplier will establish through FDI in a foreign country (Banks, hospitals, advertising firms)

Mode 4 – Movement of natural persons – Where individual service suppliers travel abroad on a temporary basis to work (doctors, accountants, IT professionals).

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

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The trade in services agreement will adopt a positive list and request-offer approach. Accordingly, both sides exchange request lists specifying the sectors and sub-sectors where they wish to receive market access and national treatment commitments from the other party. The other party can then choose to make liberalisation commitments within their comfort zones and developmental interests. Therefore, even if India requests Sri Lanka to completely liberalise a particular sector, Sri Lanka need not fully acquiesce with India's request and can limit commitments only to areas that are within comfort levels and development requirements. Alternatively, it can offer no commitments at all in that sector. The positive list approach provides both countries with a great deal of flexibility in making commitments. This is unlike the negative list approach, where everything is liberalised except those specified in the negative list. Furthermore, like the existing ILFTA, the CEPA fully recognizes the asymmetries between the two countries and less than full reciprocity is expected of Sri Lanka.

Draft Offers

This section will provide an overview of draft offers exchanged by the two countries. Since the specific commitments remain under negotiation, these offers are subject to revision.

India – India's overall commitments are very liberal in modes 1, 2 and 3. There are restrictions in Mode 4 but there is market access provided to the following categories.

- Business Visitors (BV) - for sale or to secure agreements for trade in services or for employees of a Juridical Person (JP) to set up commercial presence – 180 days and the BV will not receive remuneration in India

- Intra-Corporate Transferee (ICT) - employee of a JP in Sri Lanka who is transferred to a JP in India owned or controlled by the JP in Sri Lanka, for temporary provision of services. This is limited to managers, executives and specialists and the maximum period of stay is 5 years.

In addition to business visitors and intra-corporate transferees market access will be provided for Contractual Service Suppliers (CSS) and Independent Professionals (IP) in the following sectors. Engineering, Computer and Related Services, Hotels and Restaurant services, travel agency/tour operator services, Architecture, Integrated engineering services, Urban planning and landscape architecture, R&D services, Management consulting services, Services related to management consultancy, Tourist guide services.

- Contractual Service Supplier (CSS) - employee of a JP owned or controlled by Sri Lanka who travels to India to perform a service pursuant to a contract between the JP in Sri Lanka and the client in India. CSS for periods up to 1 year.
- Independent Professionals (IP) – natural persons traveling to India for short periods up to 1 year to perform a service pursuant to a contract between him and the client in India.

In terms of overall commitments India has made draft offers in the following sectors.

Accounting, Architecture, Urban Planning, Engineering & integrated Engineering, Medical and dental, Services provided by nurses, midwives, paramedical and physiotherapists, Veterinary services, Computer and Related services, Research and Development Services, Real estate services, Rental and leasing services, Management consultancy, Technical testing and analysis, Services incidental to energy distribution, Maintenance and repair of equipment, Building cleaning services, Placement and supply of personnel, Packaging services, Convention services, Motion picture or video distribution, Construction services, Wholesale trade, Higher education, Environmental services (refuse disposal, sanitation), Tourism – hotels, travel agency and tour guiding, Telecommunications, Financial Services and Maritime Services.

In almost all of these sectors Sri Lanka will get full market access to modes 1, 2 and 3 (except in accounting which is limited to mode 1 and 2, architecture where mode 3 access requires a joint venture and R&D in agriculture which is limited to mode 1). In terms of mode 4, business visitors and intra-corporate transferees get access to almost all sectors while contractual service suppliers and independent professionals get access to the sectors specified earlier.

Sri Lanka – Compared to India, Sri Lanka's draft offers are somewhat limited. Sri Lanka's offers build upon what is on the table at the current Doha round of WTO GATS (General Agreement on Trade in Agreement) and include a few additional sectors based Sri Lanka's service import needs. Offers in mode 4 (movement of professionals) are almost nil and other offers are all either at or below the current level of liberalization that is autonomously accorded through Sri Lanka's investment and exchange laws.

In telecom, Sri Lanka's offers are the same as those reflected in the WTO but instead of numerical ceilings, service provision in the specific sub-sectors will be allowed once a license is obtained through the standard procedure. In financial services, banking, Sri Lanka provides 100% foreign equity in Mode 3 conditional upon licensing. There is also a minor increase in Mode 4 allowance for foreign executives, conditional upon extra capital investment. In computer and related services Sri Lanka's draft offer allows access through modes 1,2 and 3 but mode 4 is limited to expert trainers and high end technicians – again conditional upon capital investment. In convention services Sri Lanka provides market access through modes 1 and 2 while mode 3 is allowed as long as it is in the form of a joint venture. In health services Sri Lanka has made an offer in mode 1 (telemedicine) on a doctor-doctor basis for purposes of a 2nd opinion. This does not include doctor – patient contact. In mode 3 in health services market access is liberalised outside the Western Province. There are no commitments in mode 4 in health services. In tourism services market access is allowed in modes 1, 2 and 3. In maritime services, offers are made in passenger transportation (not freight) with 40% foreign equity in commercial presence. In freight forwarding the offers reflect what is allowed autonomously – that is 40% foreign equity. In maintenance and repair of sea-going vessels, stakeholder consultations with Sri Lankan service providers including Colombo Dockyards made it clear that the ability to deliver the export of vessel repair services was being impaired by shortages of certain skill categories. Accordingly, Sri Lanka's draft offer included the import of certain skill categories from India in the maintenance and repair of sea going vessels including naval architects, skilled welders and fitters, project/ship repair managers, repair engineers and automation engineers. This allows Sri Lankan companies providing such services easier access to much required skilled labour. However any Indian labour entering through this agreement will need to obtain a temporary employment contract with a Sri Lankan employer and will be subject to all relevant immigration laws and work permits.

- **Opportunities for Sri Lanka through CEPA**

In terms of trade in services through CEPA, Sri Lanka stands to benefit through both export of services to India and through the import of services from India.

Export opportunities

Given the slow progress of the WTO services negotiations, Sri Lanka stands to benefit from early access to the large and growing Indian services sector by engaging in the CEPA. As incomes increase at almost double digits annually, the demand for services will continue to expand in India. Furthermore, with economic growth wages in India have increased relative to those in Sri Lanka, and coupled with the effect of an appreciating Indian Rupee, services offered by Sri Lanka have become relatively competitive in the Indian market. It is possible that access to the Indian market may attract investment from third parties into Sri Lanka, looking to export services to India through joint ventures with Sri Lankan firms. Whilst India's regime is at present quite liberal – it is not a guaranteed position over time. The CEPA will provide legally binding market access to India – over and above what is available to other countries.

In sectors such as accounting and book keeping, architecture, computer and related services, research and development services, travel agency and management consultancy, there is scope for export of services through mode 1 (and also mode 3). Such services are already supplied on a smaller scale to more developed nations therefore the potential is available. There are more sectors of potential when considering entering the Indian market through commercial presence. These include construction and engineering services, financial services (banking, insurance, leasing, and asset management), tourism and hospitality services, maritime services – specially repair of vessels which is already happening on a large scale and logistics services. Many of these sectors have already seen Sri Lankan presence in India. Despite India's strength in the IT sector certain Sri Lankan firms have been able to sell services in India (Interblocks sold internet banking solutions to Indian banks, Microimage provided Tamil SMS adoption to Airtel India). In tourism several major Sri Lankan firms such as John Keells and Jetwing have expressed interest in investing in the Indian market whilst other firms such as Aitken Spence and several smaller establishments have already been set up in Tamil Nadu. Sri Lanka's construction industry too has recently shown interest in global ventures, particularly the Gulf market, therefore the potential exists to expand to India as well where construction is increasing at a rapid rate in both the residential and commercial markets. The CEPA will also provide opportunities for Sri Lankan professionals to work in India in many of the above mentioned sectors. This applies to Independent professionals (independent individuals supplying a service to India), contractual service suppliers (individuals working for a Sri Lankan firm that supplies a service to India) and intra-corporate transferees (transfer of an individual from a firm in Sri Lanka to the representative branch in India). The CEPA negotiations provide a platform for interested parties to request the removal of barriers to export of services from Sri Lanka to India in these and other sectors.

Import Opportunities

Sri Lanka's services regime is largely liberal at the autonomous level. Therefore a commitment in the CEPA will legally lock-in the level of liberalisation committed to in the agreement (not necessarily the same as what is autonomously accorded). This will provide security and predictability to the investor - an important factor in terms of attracting investment to the country. In the past, increased foreign participation in Sri Lanka's services markets has had wide ranging benefits for business, consumers and overall economic efficiency. Examples of this include telecommunications and finance, where liberalisation resulting in competition led to significant improvements in service delivery, technology, consumer choice and prices. Similarly, Sri Lanka stands to gain through increased foreign participation in sectors such as construction, higher education and health. An overall increase in competition in services that are inputs to business such as IT services, accountancy, marketing and distribution will help reduce costs of production and improve access to quality and skills. This applies to mode 4 as well, where Sri Lanka could consider making commitments in areas where performance constraining skill shortages exist in the country. However, as stressed earlier, large scale liberalisation need not occur at once, and can take place according to the country's requirements and comfort levels.

- **Challenges**

Despite the benefits of liberalising trade in services much scepticism remains, particularly with regard to the Indo-Lanka CEPA. The biggest concern is the fear of "flooding" by Indian professionals and firms. However this fear is misplaced since under the positive list approach, services liberalisation can be controlled to the extent one is comfortable with. More serious concerns are issues pertaining to regulation – where many Sri Lankan regulatory authorities lack the resources to effectively regulate the activities of foreign professionals working in the country. Another issue is the equivalent of "non-tariff barriers" in trade in services. Despite getting market access in the Indian market, Sri Lankan firms have had difficulties in terms of excessive bureaucratic delays and hidden regulations that have made commercial operation problematic. These issues will need to be dealt with effectively in the CEPA and it is in the interest of Sri Lankan service suppliers to highlight such concerns to the relevant government authority engaging in negotiations with India.

Several Sri Lankan firms such as Damro have successfully entered the Indian market and it is important to realise that India is becoming increasingly open to foreign economic integration. In 2007 FDI into India amounted to almost US$ 25 Billion and imports were over US$ 180 Billion. The rest of the world is able to get a foothold in India, therefore Sri Lankan firms need to be positive and look to do the same. Whilst there will undoubtedly be cases of failure, this is expected given the fact that India is not an easy market to get into. As mentioned above, CEPA could be used as an opportunity to deal with such problem cases. The 6 monthly secretary level implementation discussions will provide an ideal forum in this regard. At present India is engaging in similar economic partnership agreements with several major players including Korea and the European Union. Unsurprisingly, Singapore has already signed such an agreement with India, beating all other competitors. It is not too late for Sri Lanka to engage with the Indian market through CEPA – the agreement is an opportunity not to be wasted.