

1.2 trillion dollar GDP, 1.1 billion population: How best can we grow with India?

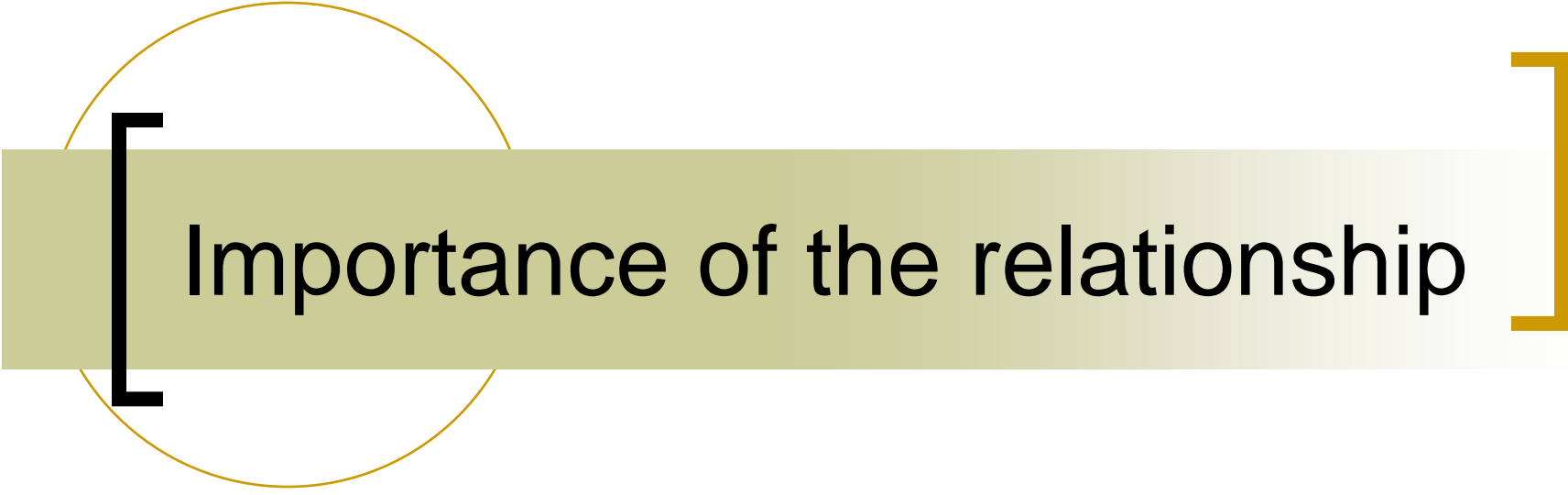
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# [ Agenda ]

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- Importance of India-Sri Lanka economic relations
- Why do we need a disciplinary framework?
  - Illustrated in relation to professionals working across borders



Importance of the relationship

# A small mental exercise: Which scenario is feasible?

- India growing without Sri Lanka
- Sri Lanka growing without India

Poor political and economic relations cause New Delhi to treat us like Bangladesh, not so much with hostility but with indifference

[ Now, back to reality . . . . ]

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# India's place in the trade and investment picture

- **3<sup>rd</sup> biggest** destination of goods exports
  - Fastest growth in past few years
- **Biggest** source of goods imports
  - Displaced Japan in 1997, before FTA; but still on a fast-growth path
- **Fifth** as a source of Foreign Direct Investment
  - Mostly in services
- Appears a **significant** destination for Sri Lankan FDI
- **Dominant** trading partner in many service sectors
  - Port and airport services
  - Tourism
  - Health and educational services (for middle-income groups)

# [ Selected data ]

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- More detail in the draft discussion paper
- Just a few indicative slides here
- Plus a brief discussion on possible effects of FTA

Most imbalanced

*Table 3: Trade between India and Sri Lanka 2001-2002 (USD millions)*

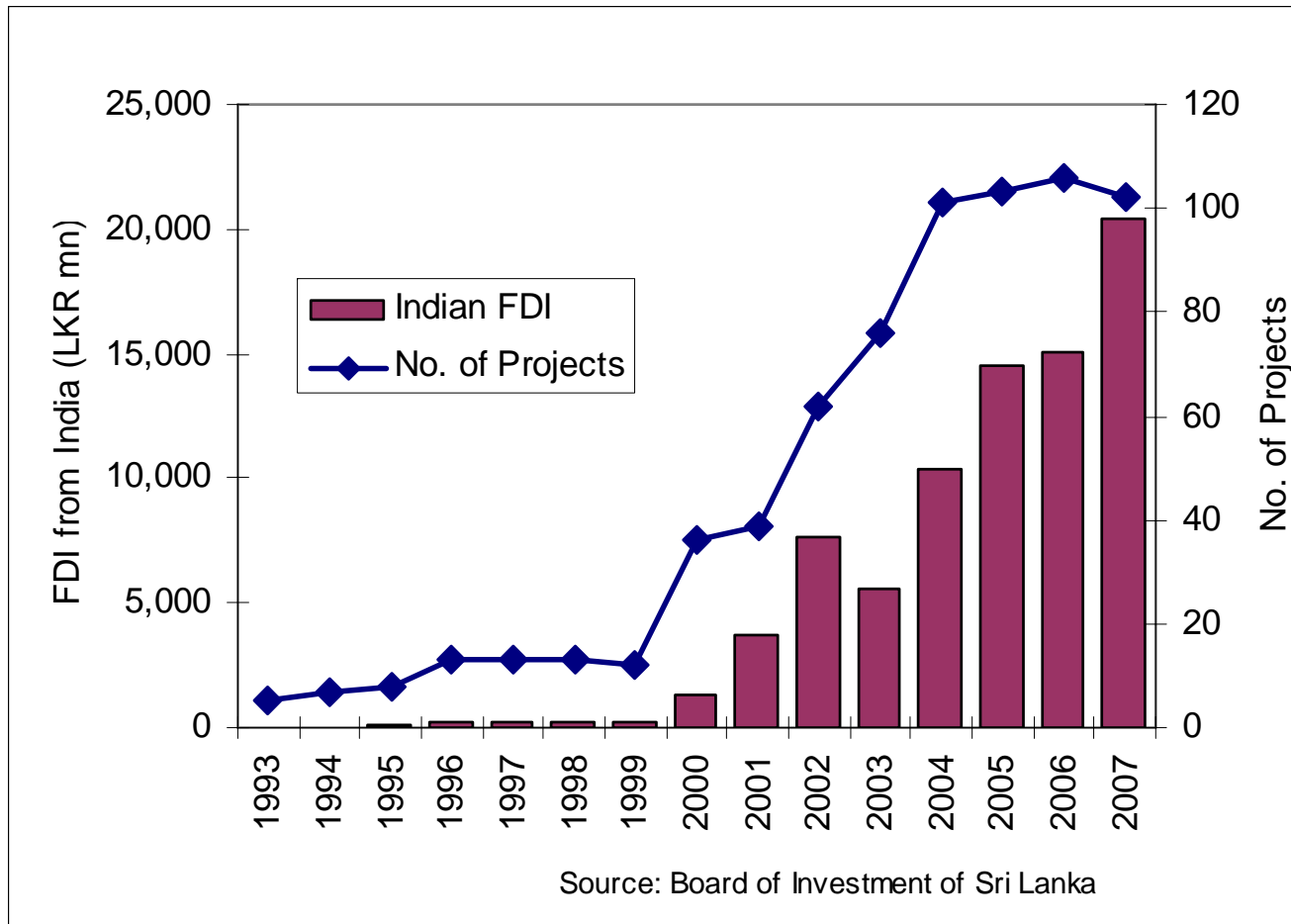
Year	Exports	Imports	Total Trade	Balance of Trade	Import / Export Ratio
2001	70.1	601.5	671.6	-531.4	<b>8.6:1</b>
2002	168.9	834.7	1,003.6	-665.8	4.9:1
2003	241.1	1,076.2	1,317.3	-835.0	4.5:1
2004	385.5	1,358.0	1,743.5	-972.5	3.5:1
2005	559.3	1,440.4	1,999.7	-881.1	<b>2.6:1</b>
2006	494.1	1,822.1	2,316.2	-1,328	3.7:1
2007	515.6	2,749.6	3,265.2	-2,234	<b>5.3:1</b>

Source: Department of Commerce, Sri Lanka

Least imbalanced



# Cumulative increase in Indian FDI in Sri Lanka, 1993-2007



← FTA →

# Effects of FTA: Imports

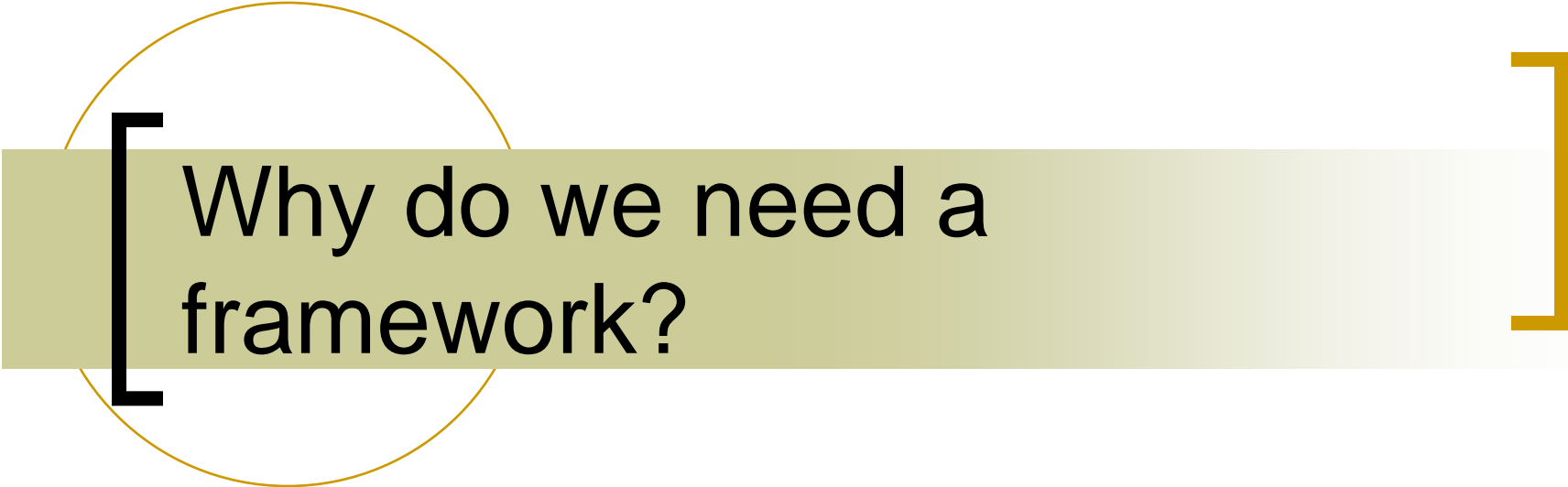
- Imports were growing anyway; most imported items are still outside the scope of the FTA
  - Sri Lanka's imports under the FTA which amounted to LKR 42,627 million in 2007 was only about 14 percent of the country's total imports from India
- Imports started rapid increase in 2005, when petroleum imports started growing rapidly
- Unproductive to talk about growing imports and trade deficits as a problem, if the imports are lowest-cost and beneficial to consumers and those who use them as inputs to value-added products

# Effects of FTA: Exports

- If not for FTA, trade deficit would have been even larger
  - Import:export ratio in 2007 (5.3:1) is still lower than at start of FTA (8.6:1)
- Indian measures on copper and vanaspati have slowed down exports
  - If rules of origin rules are satisfied, should allow Indian investors to export from Sri Lanka into India

# Effects of FTA: FDI

- Qualitative increase in FDI since 2000 when FTA came into operation
- Causal mechanism is not conclusively established, but correlation exists
  - Possible that higher profile of Sri Lanka as a result of India's first FTA, drew in FDI
- Sri Lanka has also invested in India, mostly after FTA came into effect



Why do we need a  
framework?

# National sovereignty v international discipline

- “Obviously any international discipline entails some yielding of sovereignty by national governments” --John H. Jackson (1988)
- What is sovereignty?
- What is an international discipline?

# [ What is sovereignty? ]

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- From kingly power
  - “I can do anything but make a man a woman . . . .” (Statement made in Sri Lanka in 1978)
- Never absolute, unless fully isolated, e.g.,
  - Bachelor/Marriage
  - Home schooling/School

# [ Sovereignty → disciplinary framework: An analogy from the schoolyard ]

- State of anarchy (no rules)
  - A bully who steals lunch, randomly
  - 5 victims
- Proposal for order
  - The victims propose they take turns to deliver lunch to bully
- Why would victims make the offer?
- Why would bully accept?



# [ Unjust, but better than anarchy ]

- Is bully better off?
  - Certainty of snack availability
  - Reduction of risk
- Are victims better off?
- What is the “discipline”?
  - Collective actions against
    - Victim who does not bring lunch on appointed day
    - Bully who steals lunch from one who should be safe

# [ Moral of the story ]

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- Constraints on sovereignty (freedom to do anything) are not always bad
- If even an unjust framework yields some good, how much more good will there be in a just framework?

# [ Jackson continuum ]

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- From the most power-oriented environment (no rules) to most rule-oriented (disciplinary framework in the fullest sense)
  - With normative value attached to latter
- One must, of course, ask how the rules were made

Power-oriented

Interaction, but no rules

Bilateral rules (3<sup>rd</sup> Best; best we can get)

Plurilateral rules (2<sup>nd</sup> Best)

Multilateral rules (1<sup>st</sup> Best)

Rule-oriented

# [ Why trade agreements? ]

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- Because they provide safeguards against arbitrary exercise of power by states
- To the extent that the agreements are fair and properly implemented (esp. dispute resolution), small countries benefit more than big countries

[ An example using service  
professionals ]

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# [ Basic correlation: mobility → higher negotiating power ]

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- Land -- immobile
- Capital -- mobile
- Goods -- increasingly mobile
  - GATT and repeated reductions in tariffs
- Services – increasingly mobile
  - GATS, modes 1-3
- Labor -- decreasingly mobile (in law), esp. from developing countries

# [ Trade in services ]

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- Modes of supply
  - Cross-border supply (mode 1)
    - Supplier in A; consumer in B
  - Consumption abroad (2)
    - Supplier in A; consumer comes to A
  - Commercial presence (3)
    - Consumer in B; supplier from A invests in B
  - Movement of natural persons (4)
    - Consumer in B; natural-person suppliers come to B, with Mode 3 or without



# Reality of trade in professional services

- Modes 1 and 2 are difficult to police
  - But generate demand for Mode 4
- Mode 3 is where the focus is
  - Countries that want foreign direct investment will get it, with or without GATS
  - Particularly where Mode 4 is not rule governed, power relations dominate
    - Investors will bring in the personnel they want on a case-by-case basis

# [ Reality of trade in services ]

- Countries that “allow” Modes 1-3 will see increasing movement of professionals
  - To support services traded under Mode 1
  - To support investments made under Mode 3
- Small countries that want investment more (e.g., Sri Lanka) likely to allow greater movements than big countries with less need for foreign capital (e.g., India)
- Result sans framework: Indians in Sri Lanka; no Sri Lankans in India

# [ Status quo (worst of both worlds) ]

- Overall liberalization drives movement
- Professionals are moving across borders and practicing
- Beneficiaries are
  - High-profile stars
  - The non-law abiding
  - Those with contacts (or whose clients have contacts)
- Younger professionals are locked out of foreign work & deprived of local work

# [ Rules will benefit many ]

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- More opportunities for all
- Less room for arbitrary exercise of discretion
- Mutual recognition and enforcement of standards
- Higher standards from international exposure

# [ In sum . . . ]

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- Relationship with India is very important
  - Economic and other; will economic assist other?
- Conducting economic relations within a mutually agreed upon disciplinary framework is likely to reduce frictions and allow us to focus on the big picture
- Trade agreements tend to be more favorable to small countries than large, contrary to populist views
- A framework is of greater significance to service trade, because it's all NTBs/no tariffs
  - Services should not be held hostage to the needs of a few disaffected goods traders/investors

[ All this, without talking about . ]

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- Lower prices and higher quality
- Improving the quality of Sri Lankan professionals and service providers