

Trade policy in the aftermath of the Great Recession

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30 August 2010

**Nobel Laureate Michael
Spence @ Mt Lavinia**



- Chair, Commission on Growth & Development
 - Basic problem is the shortfall of USD 1 trillion in demand, which will not come back unless US house prices return to pre-crisis levels
 - This will not happen
 - Can the demand come from elsewhere?
 - Natural reaction, despite the bad experience of 1930s (60% decline in world trade was result of Smoot-Hawley Act), is to become protectionist and preserve the remaining demand for local industry

The offensive/optimistic
response (Plan A)

Can Asia fill the demand gap?

- Demand = people with money
- How can people with money be created?
 - Growth
- According to the Commission, growth comes with
 - Integration to global value chains
 - Application of knowledge to economic activities

Leave aside Asia, what about Sri Lanka?

- Value chains
 - Now that the war is over, can we
 - Connect more value chains to the global economy?
 - Increase the integration of these value chains?
 - Make these value chains more inclusive?
 - Does global have to mean US and Europe?
- Application of knowledge = productivity
 - How can we increase the application of knowledge, and thereby productivity across the economy?

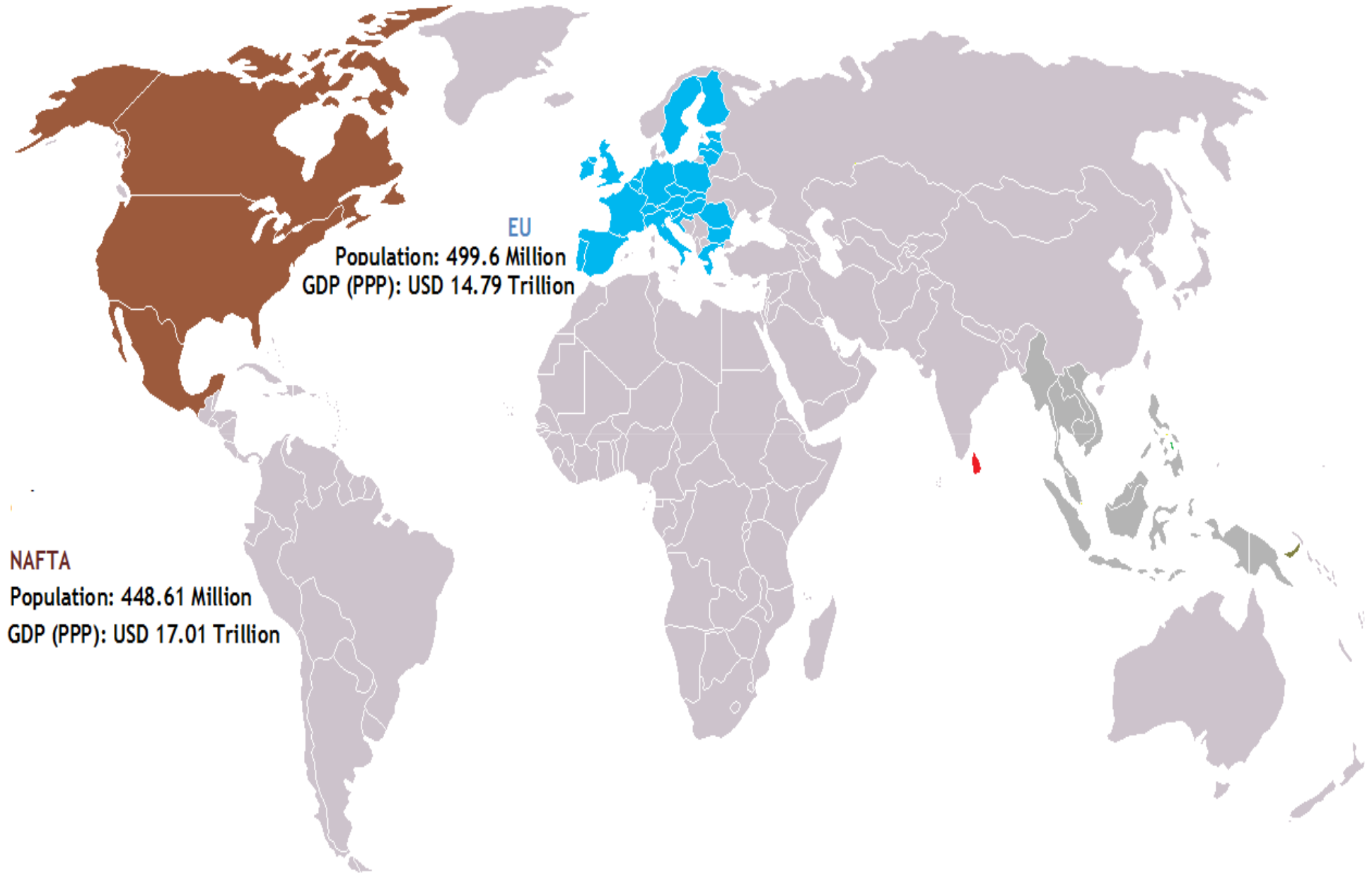
Our chances of success

- Will they be better
 - If we draw on skills and capital, OR
 - If we try to do it on our own?
- Does CEPA help or hinder?

The defensive/pessimistic
response (Plan B)

Hopefully we will not see full
protectionism like in 1930

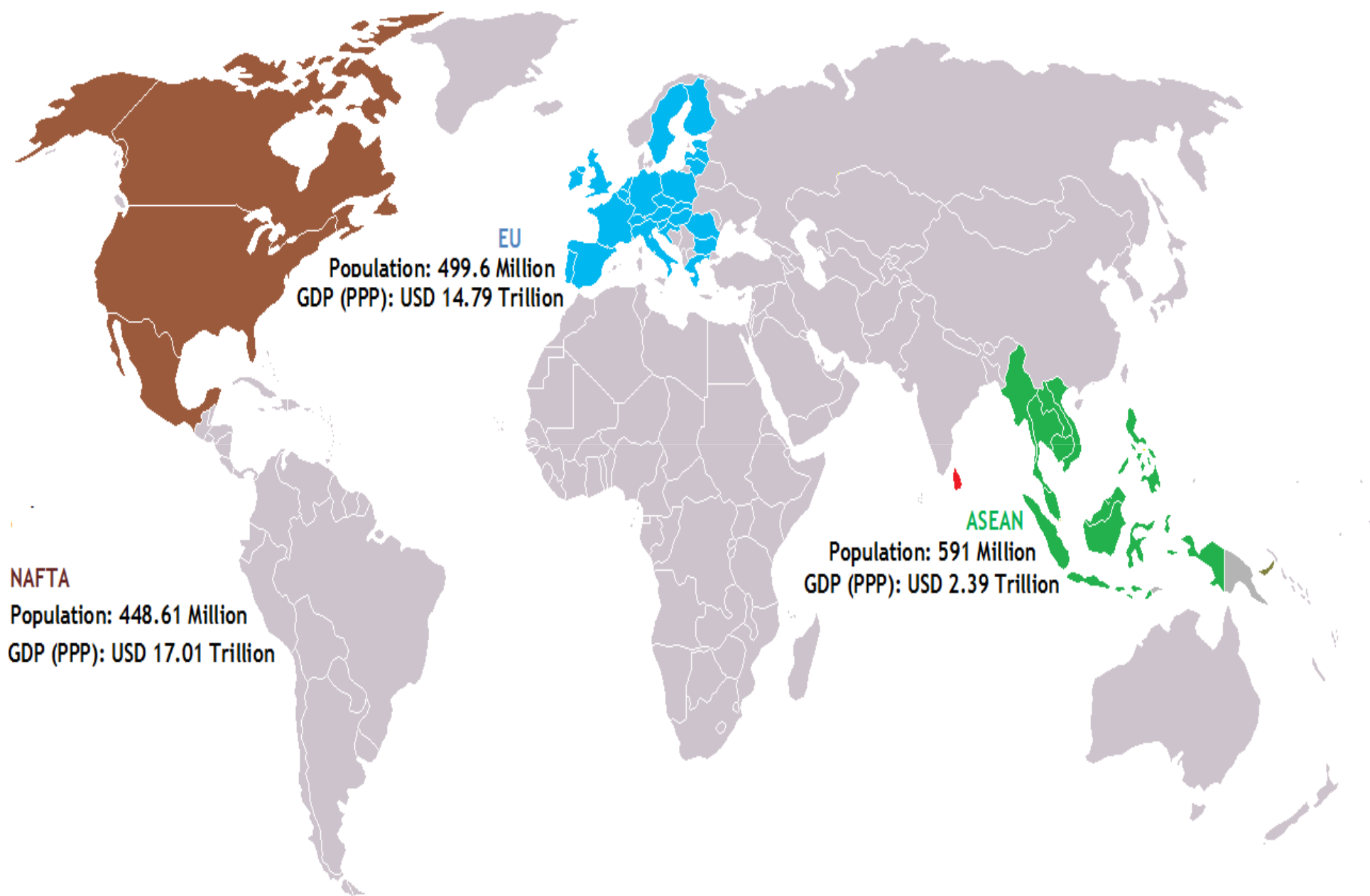
- But, perhaps two fortresses, emerging from the already existing trade blocs, NAFTA and EU?



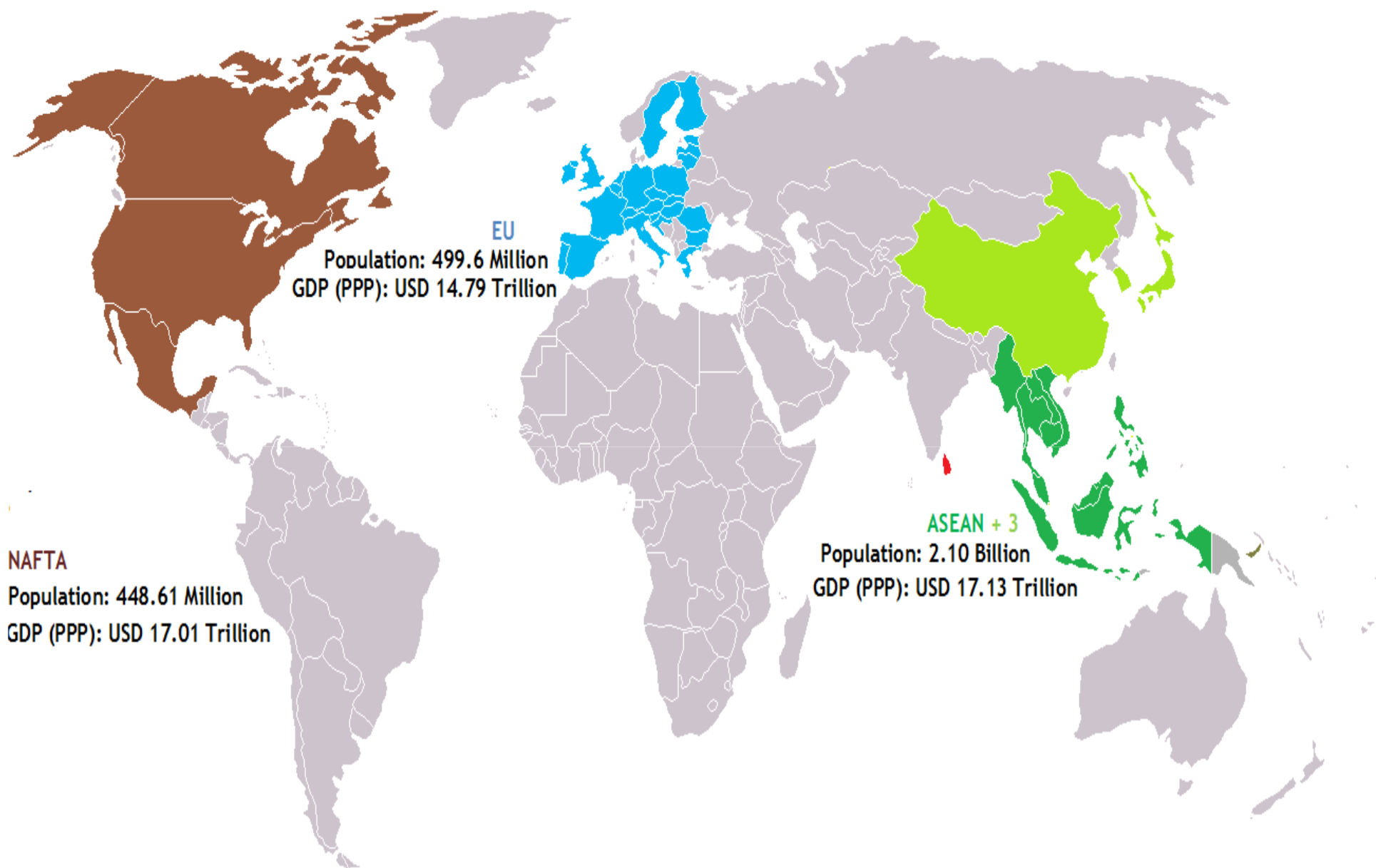
Data Source: IMF (2010) World Economic Outlook Database & Eurostat

And a third? But who will be in? And out?

- What about Asia, the growth engine?
 - ASEAN+3 proposed by China (ASEAN+ China + Japan + South Korea), OR



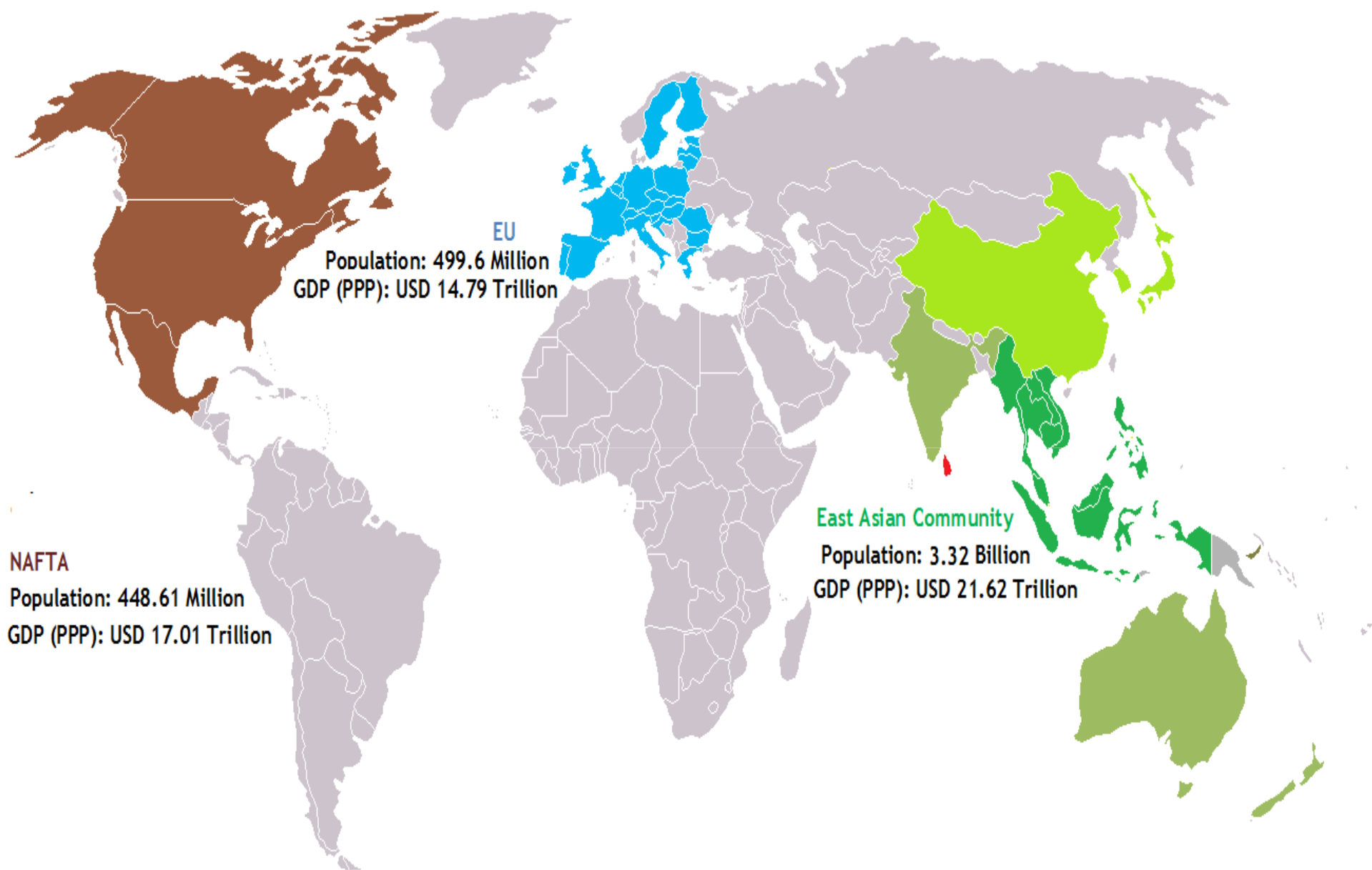
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Or, another option?

- East Asian Community proposed by Japan & Australia (ASEAN+3 + Australia + NZ + India)?



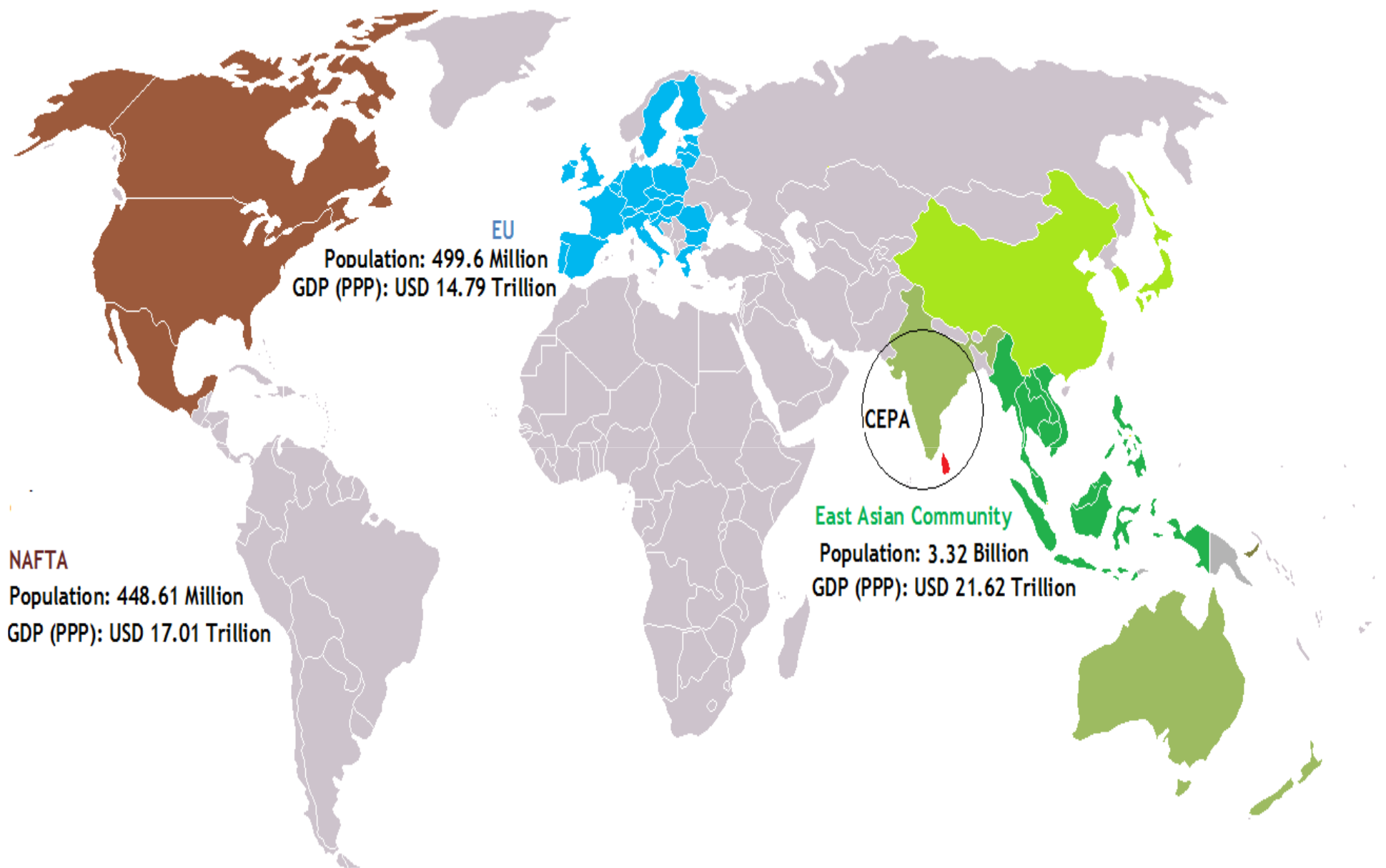
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Is Sri Lanka included in either option?

- China is promoting ASEAN+3
 - But no mention of Sri Lanka
- Japan and Australia are promoting East Asian Community
 - No mention of Sri Lanka either
- Only India wants to sign CEPA with us

In a world of fortresses . . .

- How will life be for those outside?
- How realistic are the chances of Sri Lanka being invited to the party on its own?
- But like the Lome Convention countries got connected to the EU, can we also benefit from being in CEPA?



Data Source: IMF (2010) World Economic Outlook Database & Eurostat

This is the context of CEPA

- Isolation does not seem a good option in either response to the Great Recession
 - We need to increase productivity
 - We need to integrate with global value chains more
 - We need to make sure we're not left out of the emerging fortresses

An example of integration with global value chains

- Business Process Outsourcing (BPO) or IT enabled services (ITES)
- How it grew from 2004 and how unilateral liberalization helped

Examples of barriers to trade in services that may be addressed

- Hypothetical, using an industry that is most likely not being fully liberalized under ISLCEPA
 - Mode 1: Seller remains in Country A; buyer remains in Country B
 - Telemedicine: seller in Chennai (e.g., Apollo); buyer in Colombo
 - Are there professional bodies that prohibit/license?
 - Mode 2: Buyer comes to Country A to consume service
 - Health tourism: seller in Chennai (Apollo); buyer from LK flies in for consultation/operation
 - Are there rules against? Are there ways to prevent?

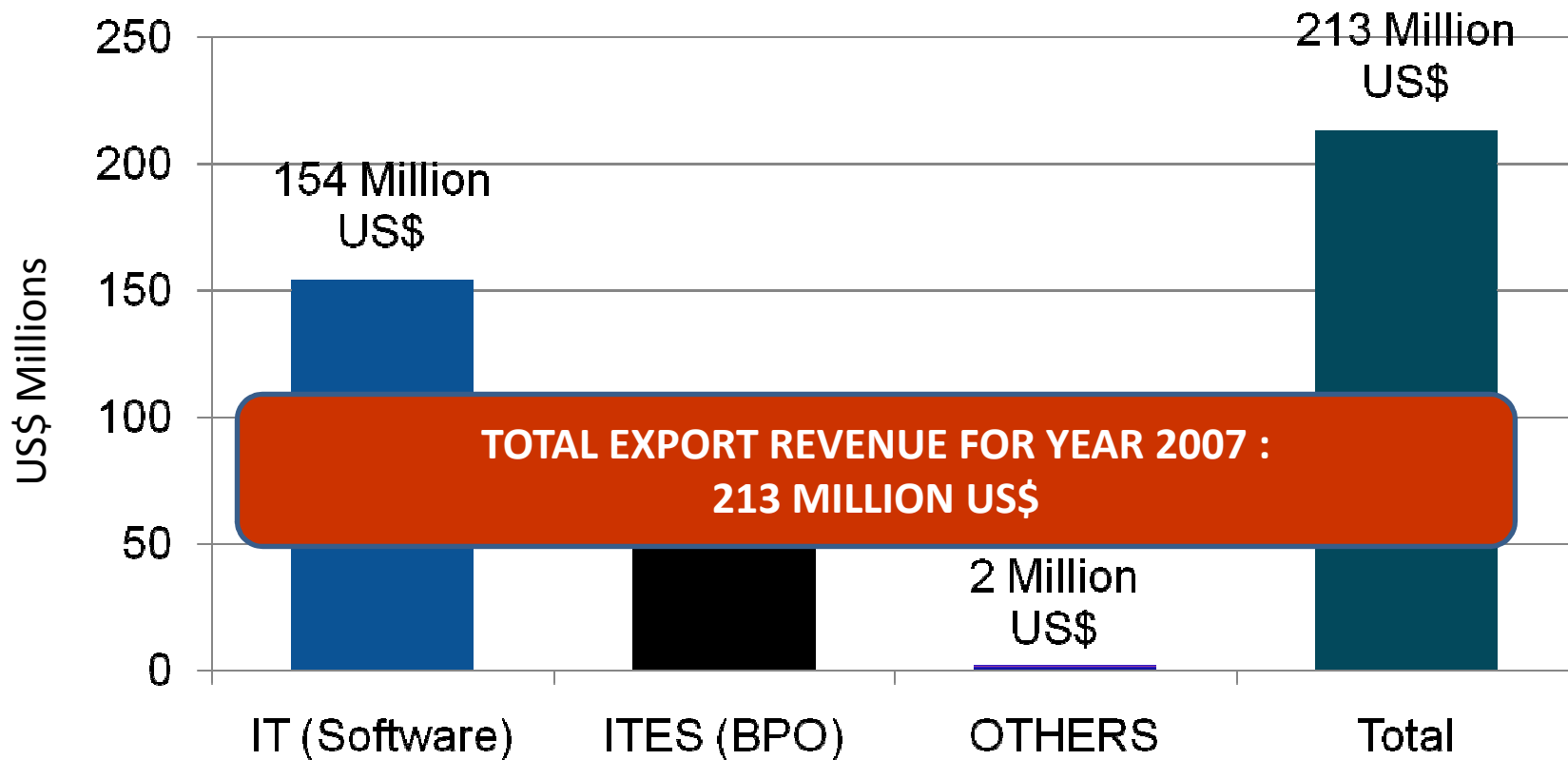
Examples of barriers to trade in services that may be addressed

- Mode 3: Seller establishes commercial presence in Country B to supply services
 - Apollo sets up hospital in Colombo to serve patients in their own country
 - FDI regulations
 - Theoretically possible to do Mode 3 without Mode 4, but highly unusual because brand value is tied to people
- Mode 4: Natural persons coming to Country B to supply services
 - Indian doctors come to LK to work at Apollo
 - Professional licensing regulations

ITES: an industry that benefited from unilateral liberalization (without laws/agreements)

- Liberalized telecom industry to allow supply by multiple firms and adequate investment, from 1990s
 - No restrictions on Mode 3; Mode 4 permitted under BOI
- Liberalized international telecom market in 2003, ensuring redundancy of international telecom service suppliers and media
- Improved IT education
 - Local supply and Modes 1-3
- Capitalized on niche strength in accountants
 - Local supply as well as Mode 1 & 3
- Attracted marquee BPOs to Sri Lanka (Mode 3) and facilitated others; now ranked 16th in attractiveness for locating services (India #1; Philippines #8; Pakistan #20)
- Software industry rose on own strength

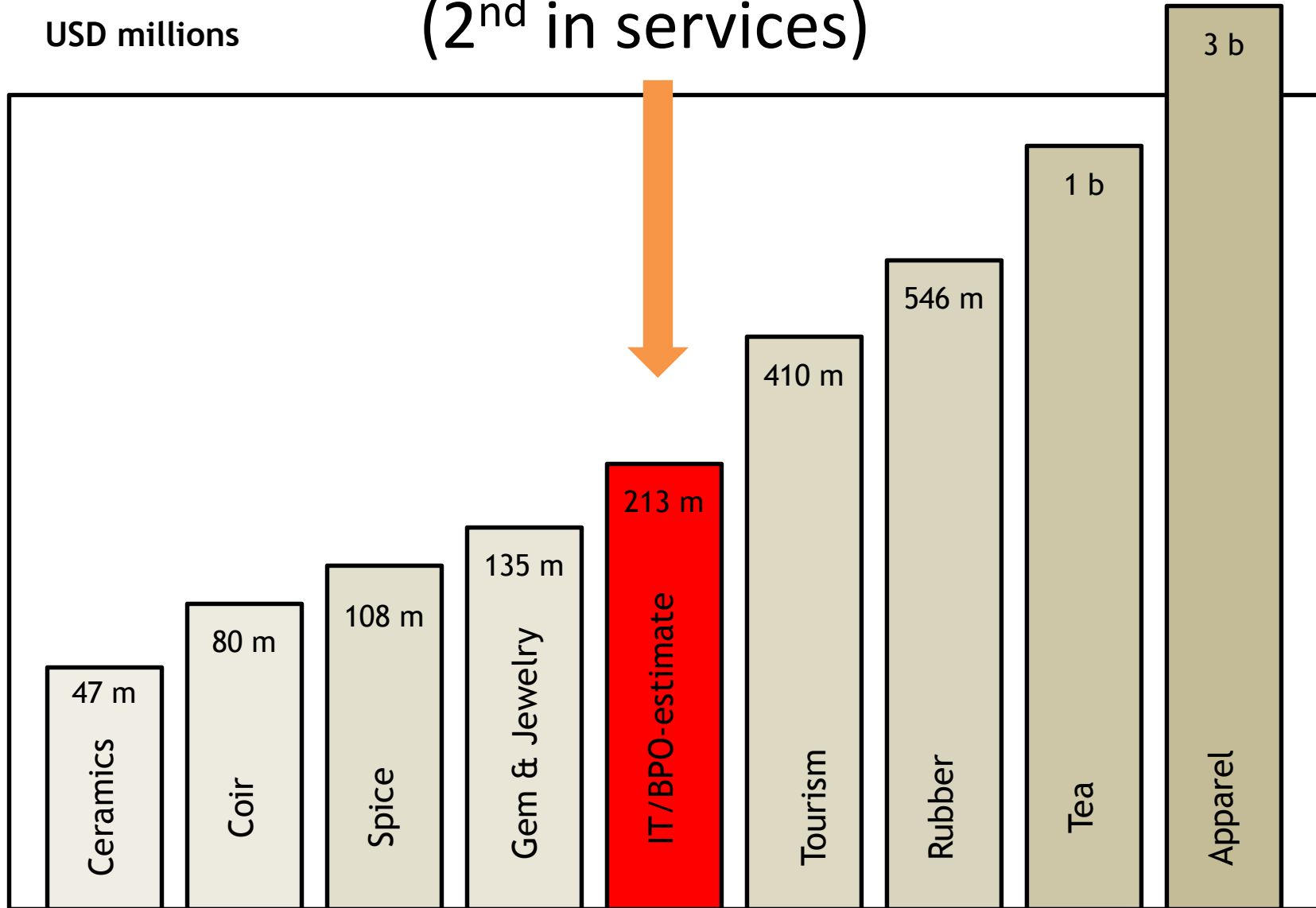
IT & ITES Export Revenue 2007



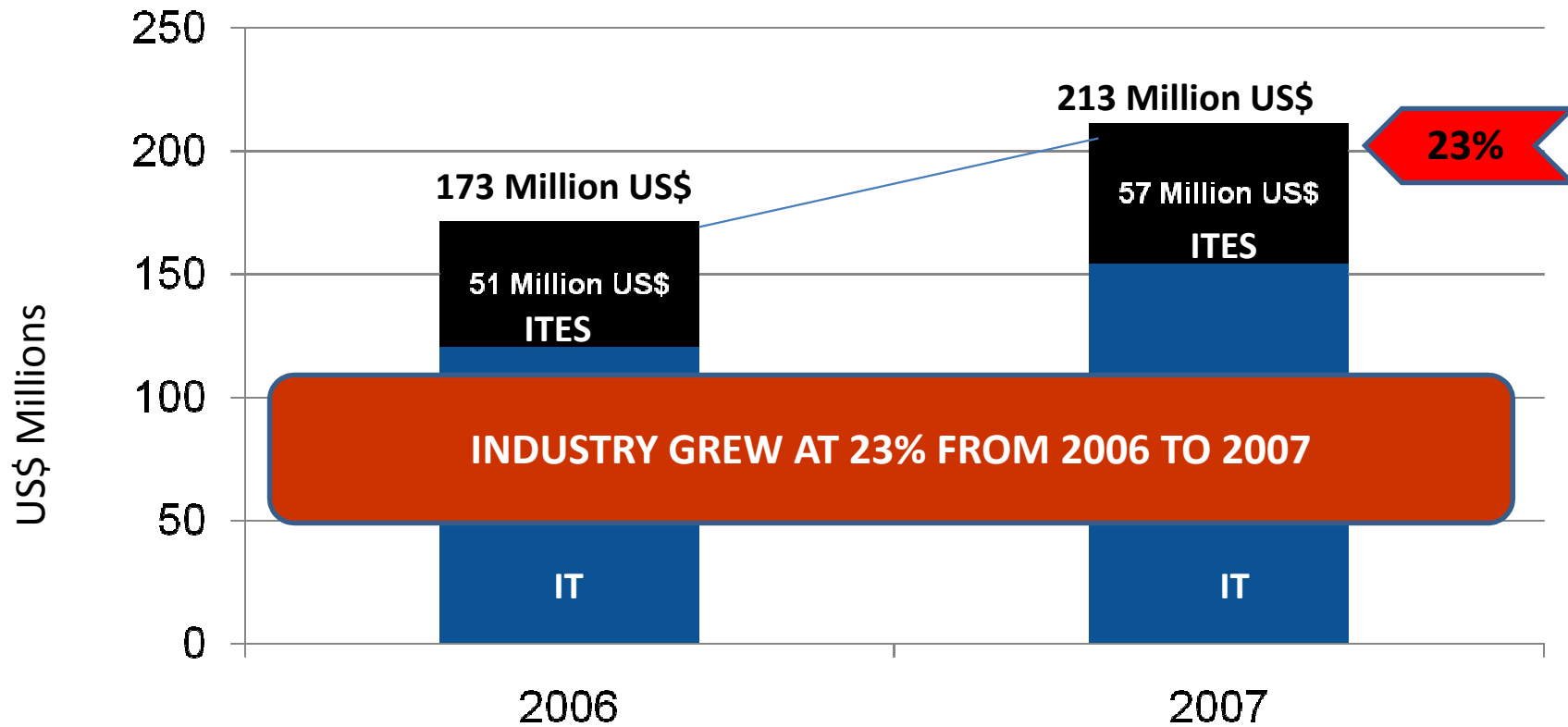
5th Highest Exports Revenue Earner in 2007

USD millions

(2nd in services)



IT & ITES Industry Growth 2006 to 2007



Industry	2006	2007	Growth
IT	120 Million US\$	154 Million US\$	28 %
ITES	51 Million US\$	57 Million US\$	13 %
Both	1.675 Million US\$	1.875 Million US\$	12 %

From 2010 June Budget Speech

- “Although Sri Lanka was not known for exports of IT and business processing services, since 2005 this activity has graduated to earn around US\$ 250 million of foreign exchange, in addition to giving a place of pride to our IT professionals This sector has a comparative advantage to become a billion dollar export activity”

Budget Speech sees service exports as future (but Mode 4 emphasis too much?)

- “ . . . we must not explore only our export potentials in manufactured products but also in a wide range of services such as ports, aviation and professional services, to maximize our earning capacity. Our government’s vision is to increase the skills of our labour force which is looking for overseas employment to enable much higher income. A skilled labour force could double earnings from overseas remittances which are currently in the range of US\$ 3.5 billion.”

Government: This is it?

- Where is the vision?
- Where is the strategic thinking?
 - Opportunities
 - Threats
- No response to protectionists
- No leadership

Perhaps trade policy (strategic economic policy) is too important to be left to the government?

Chambers lacking imagination and courage?

Think tanks? What think tanks?