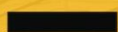# EVALUATION OF TRADE AGREEMENTS

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A CASE STUDY OF PAKISTAN-SRI LANKA FTA

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Evaluation of Trade Agreements: A Case Study of Pakistan-Sri Lanka FTA

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Introduction

In the wake of recent failures of multilateral trade negotiations, regional trade agreements have gained immense popularity. The later is not only viewed as an integral part of economic policy but also as an instrument of foreign policy (Mastel, 2004). Over 50 percent of global trade now occurs within trading blocs and almost every country is a member of some regional trade agreement. While most FTAs still focus on the movement of goods, however deeper forms of integration such as common markets and economic unions allow for free movement of factors of production and harmonization of national economic policies respectively. Most regional agreements also put forward discriminatory stance for non-members and are certainly contradictory to the principles of the WTO. The economic and in particular the development effects of regional agreements have to be understood in terms of trade creation[1], trade diversion[2] and transfers[3]. Ironically in the political economy context the resistance is highest for (preferential) regional agreements that result in trade creation where imports replace domestic production.

The total number of agreements has grown from 1 in 1975 to 216 in 2009, the main rise taking place after late 1990s. Out of the total 216, around 45 FTAs presently stand proposed, 16 are at the signing stage, 46 are under negotiation, 27 are signed and

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[1] Trade creation takes place when a member country of the regional agreement (Country A) increases its imports from its partner country (Country B) without a reduction in Country A's imports from the rest of the world.

[2] Trade diversion takes place when imports from the rest of the world are replaced in Country A by more expensive imports from Country B (because goods from Country B do not pay tariff while goods from the rest of the world do.

[3] Transfers occur between member countries of the trade bloc because removal of tariffs between them means that exports obtain better prices in the partner's markets (positive transfer), while the costs of imports net of tariffs increase (negative transfer).

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concluded, and 82 are under implementation. The increase in the number of proposed and under implementation FTAs points towards an increased preference for regionalism at the global level[4]. Out of the total 216 FTAs, 166 are bilateral i.e. preferential trading agreement involving only two parties and 50 are plurilateral i.e. preferential trading agreement involving more than two parties. In South Asia the highest number of under negotiation and concluded FTAs by 2009 originated from India (32) followed by Pakistan (26).

This book assesses the impact of Pakistan-Sri Lanka Free Trade Agreement (PSFTA) in stimulating trade performance. We provide a brief overview on evaluation of FTAs across the literature followed by a discussion on objectives of PSFTA and details on trade flows pre and post FTA. The explanation regarding data and methodology are then followed by results on the potential gains from PSFTA.

Regional trade agreements with specific reference to South Asia

The growth in FTAs in most parts of the world indicates that regionalism is now here to stay and the focus of policy makers should be towards reducing the cost of FTAs and maximizing their benefits (see Kawai & Wignaraja 2009). The design of these agreements has been argued to be constraining on development goals of poor countries. Thrasher & Gallagher (2008) argue that the current global trade regime curtails the ability of poor countries to exercise control over various policies that are meant for the achievement of objectives related to pro-poor growth. Most of the trade literature on quntification of trade barriers focuses on static effects. However the dynamic effects are of more importance in the context of trade agreements and their potential to bring about economic development. Some of the key dynamic effects include: economies of scale, technology transfer, foreign direct investment (and capital accumulation) and structural policy reforms (ADB, 2008).

South Asia is seen as one of the least integrated regions in the world. There is plenty of research to show that by reducing the inefficiencies at the borders of South Asian countries, significant trade gains can be achieved (Weerahewa, 2009). The region despite of cherishing SAFTA and several independently driven FTAs lags behind in flaring regional commercial activity. It draws low volume of intra-regional trade under the sentry of high trade

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[4] This may not be regarded as a generalized result over time.

barriers. Larger countries like India and Pakistan have an approximate trading volume of 5% to 2.5% respectively with the South Asian countries.

Despite the lowering of tariffs over the past years the non-tariff barriers (NTBs) pose a challenge for expansion in trade in this region. Examples include: transactions costs, long delivery time, payment delays, burgeoning domestic taxes, differential tariff treatments, regulatory requirements and restrictive FTAs. There has been past research on potential gains from improved trade in South Asia. See Govindan (1994), Srinivasan (1994), DeRosa & Govindan (1996), McCombie & Thirlwall (1997), Bandra & Yu (2003), Paulino & Thirlwall (2004) and Weerahewa (2007). For impact of improved facilitation on trade see Wilson *et al.* (2005). See also Wilson *et al.* (2003) and World Bank (2007). Within SAFTA, 53% of the items are subject to negative list. Weerakoon & Thenakoon (2006) argue that such a limited sectoral coverage would dissipate real essence of free trade. Regulatory framework in South Asia imposes NTBs that includes Para Tariffs[5] in addition to basic custom duties; such measures give rise to cascading effect for imported products that in turn raise prices more than actually warranted.

The still high tariffs, NTBs, non-conducive MFN, odds of trade diversion, parallel comparative advantages and region's disproportionate size of economies instill pessimism in SAFTA literature. Studies conducted by Bandra & Yu (2003) used computable general equilibrium (CGE) model for evaluation of SAFTA to show that significant benefits are slanted in favor of India while Pitigala (2005) and Baysan *et al.* (2006) showed prevalent threat of trade diversion due to the relatively high barriers[6]. These results are in contrast to Hirantha (2003) that showed trade creation while showing no signs of diversion with rest of the world. See also Srinivasan (2002) for a detailed explanation on low indices of trade complementarity.

Newfarmer (2004) and Kemal (2005) defend South Asian intra-regional trade to be an inevitable outcome given a set of limited range of products making up their export profile. Banik (2006) explains that similar export profiles in turn prompt industrial, services and agricultural sectors to cooperate in order to attain economies of scale. This necessity facilitates the overall integration

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[5] Para tariffs refer to duties and taxes that are over and above the 'border tariffs'. Normally, these include domestic taxes charged either by the Central Government or the State Governments

[6] Asserts positive outcome if regional barriers be lowered to five percent along with relaxing of the otherwise restraining rules of origin.

process. Seekkuwa (2004) using gravity analysis showed impressive trade creation effect while finding no evidence of trade diversion with rest of the world provided tariff ceilings are brought down. Studies conducted by Sriniavasan & Cananero (1993) and Batra (2004) suggest that tariff removal would lead to expansion in trade for India, Pakistan, Bangladesh, Sri Lanka and Nepal. The study also indicates benefits from unilateral trade liberalization that weighs more compared to preferential liberalization moves[7].

Pigato *et al.* (1997) shows that benefits emanating from unilateral trade liberalization would go in favor of India while preferential liberalization being fruitful for the rest of South Asia. Batra (2004) while analyzing India's trade with 145 countries discovers her greatest potential in SAARC region exists with Pakistan. Govindan (1994) suggests an increase in welfare gains through food trade expansion within the region. De Rosa & Govindan (1995) predicted that trade-led welfare gains could be augmented by increased regional economic integration with the rest of world or Asia Pacific. Sengupta & Banik (1997) predict intra-SAARC trade to expand by 30 to 60% if all illegal trade through direct and indirect medium be routed through official channels.

As most of South Asian countries are dependent on the outside world for their imports thus a positive spillover effect would further promote SAARC's intra-regional trade. There lies a need for further gravity analysis by incorporating such elements like the logistics of this region and its effects on regional bilateral trade flows (Raihan, 2008). There has yet to be some concrete research on the ex ante gains, if SAFTA is used as a common platform for negotiating collective FTAs with other regions. Examples of such arrangements exist in case of EU and ASEAN. For the latter see Calvo-Pardo (2009). See also Laurenceson (2003). The rise of trading blocs has also impacted the various industries differently. For the impact of regionalism on for example textile trade in the context of EU, NAFTA, AFTA, and SAPTA, see Tsang (2008).

The examples of FTAs within South Asia include India – Sri Lanka, Pakistan – Sri Lanka, Pakistan – Bangladesh (under negotiation), India – Bhutan, India – Nepal[8], and Pakistan – Nepal (under consultation). The India – Sri Lanka FTA signed in 1998 moved towards a Comprehensive Economic Partnership Agreement (CEPA) in 2002. This agreement is intended to boost

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[7] Raihan (2008) calculated the stretch of trade creation versus trade diversion in SAARC region under the context of SAFTA. For a discussion on how FTAs bring about trade creation or diversion see also Girma (2008).

[8] Indo – Nepal treaty of trade.

the ties between the two countries in the areas of cooperation in investment and trade in services[9]. The trade data since 2000 indicates that exports of Sri Lanka to India have substantially increased. However if one looks at the basket of exportable items that Sri Lanka has to offer to India, not much change has come about. The two main items i.e. vegetable fats/oils, and copper still remain the main exports of Sri Lanka. The negative lists still remain large, which will be an intensive topic of discussion as CEPA moves forward.

Salient features of PK-SL FTA

The PSFTA was signed in Colombo on 1ˢᵗ August 2002. The rules for this agreement came into force with effect from 12ᵗʰ June 2005. Both parties agreed on free movement of goods and services between their countries through elimination of tariffs. The parties agreed to eliminate all non-tariff barriers on the movement of goods and services and not to make any increase in the existing para tariffs or introduce new or additional para tariffs without mutual consent[10]. All products covered by the agreement shall be eligible for preferential treatment if they satisfy the Rules of Origin as defined in the agreement.

Since PSFTA became operational in 2005, trade between the two countries has exhibited an upward trend. The value of overall trade between the countries has increased from US $ 170 million in 2005 to US $ 270 million in June 2007. There is an ample of goodwill for expansion of trade and establishment of joint ventures between the two countries in various agriculture and industrial sectors. Pakistan and Sri Lanka are lucrative investment destinations for both countries as on the one hand Pakistan is a gateway to resource-rich Central Asian States while on the other hand Sri Lanka enjoys duty-free access to EU and Indian markets.

Since PSFTA has completed its 4 years in which tariffs were eliminated by Pakistan, the analysis of this FTA is relevant at this stage to analyze whether Pakistan has benefitted from this arrangement and what were the areas that were neglected. A longer timeframe has been established for the Sri Lankan side for tariff liberalization. Pakistan, as decided, has allowed complete duty free access from June 2008. On the other hand, Sri Lanka will follow suit in terms of full liberalization by June 2010.

The PSFTA fully recognizes the asymmetries between the two countries and negotiations were finalized with Sri Lanka on a less

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[9] To see how investment decision change after bilateral FTAs see Bukley (2007).
[10] The legal information is drawn from the agreement document. See Ministry of Commerce – Pakistan website.

than reciprocal basis. Sri Lanka only offered 102 items after the FTA on a duty-free basis compared to Pakistan's 206 items. The negative list set by Sri Lanka contains 697 items compared to Pakistan's 540 items. By the end of 2010, it is expected that the tariffs will be eliminated from 69 percent of the goods traded between the two countries. The Rules of Origin criterion has been applied in the agreement to prevent transhipment of goods. In order to get preferential duty rates under the FTA, exports from Sri Lanka require 35 per cent domestic value addition. The agreement incentivizes the process of value addition in the manufacturing processes of the two countries by requiring 35 percent value addition and tariff lists at HS-6. This will increase the flexibility available for Sri Lankan and Pakistani investors to acquire their raw materials and related inputs from third countries and manufacture the product themselves for bilateral exports.

Tariff reduction / rationalization programme

Largely, the tariff restructuring by the Pakistan and Sri Lanka under the FTA would be as follows:

(a) Pakistan's commitment to the Agreement
1. No Concession List
2. 100 % Concession List (immediately upon entry into force of the Agreement)
3. Phasing out List: 25% duty reduction shall be granted immediately, increasing to 50%, 75% and 100% respectively at the end of the first, second and third year.
4. Tariff Quota List
(b) Sri Lanka's commitment to the Agreement
1. No Concession List
2. 100% Concession List (immediately upon entry into force of the Agreement)
3. Phase Out List in 3 years: 50% concession shall be granted immediately, increasing to 70%, 90% and 100% respectively at the end of first, second and third year
4. Phase Out List in 5 years: 20% concession shall be granted per annum at the end of each year.

Following are the details of Concession list, no Concession list and Tariff Rate Quota:

a) For Pakistan and Sri Lanka, the negative list (no concession list) comprise of 540 tariff lines and 697 tariff lines at 6 digit HS code respectively.

b) The concession list which mainly comprise of food items, manufactured and semi-manufactured products comprise of 206

tariff lines for Pakistan and 102 tariff lines for Sri Lanka. (Also see table 1).

c) Pakistan offered tariff rate quota to Tea, Green tea, other green tea, Black tea and partly fermented tea, other black tea and other partly fermented tea. Pakistan can import upto 10,000 metric ton for each financial year (July-June) duty free from Sri Lanka.

d) For Betel leaves the tariff rate quota is 1,200 metric ton for each financial year at Margin of Preference applied Most Favored Nation rate.

e) Articles of Apparel (Knitted or crocheted) and Articles of Apparel and (Not Knitted and crocheted) comprising chapter 61 of HS code has also been given the same tariff rate quota as for betel leaves. Chapter 61 comprises of 21 tariff lines for which three million pieces per year provided maximum of two hundred thousand (200,000) pieces is allowed at 35% of Margin of Preference.

f) Sri Lanka has provided Tariff rate Quota to Long Grain Pakistani Rice (Basmati) at 6,000 metric ton per year and Potatoes at 1,000 metric ton per year duty free.

Rules of origin

Rules of Origin have to be complied with by the exporters of the two countries in order to qualify their products for preferential duty benefits. Based on the origin, the Rules of Origin categorize the products exported under the PSFTA into the following two main segments.

a. Products wholly produced or obtained in the territory of the exporting country such as agricultural, fishery and mineral products.

b. Products, not wholly produced or obtained in the territory of the exporting country (manufactured products).

All manufactured products falling under the category (b) above should contain a minimum of 35% of Domestic Value Addition of their FOB value in order to qualify for preferential treatments. Further, it is also necessary that all non-originating materials, used by the exporters change their HS codes at six-digit level against that of the final product as a result of the manufacturing process undertaken in the exporting country.

The Cumulative Rules of Origin encourages exporters to source their inputs from the other contracting country. However, the Domestic Value Addition in the territory of the exporting country shall not be less than 25% of the FOB value of the final product, while the aggregate value addition in both contracting parties should be minimum of 35% of the FOB value. In addition, the

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respective products should also conform to the Change of HS code requirement (at six digit level) as in the case of the manufactured goods, referred to under category (b) above.

Provision for Change of HS Codes at six-digit level, has made the Rules of Origin of the PSFTA more flexible, compared to most of the other Free Trade Agreements, which stipulate that Change of HS Code should take place at four digit level.

Table 1. *Chapter wise concession lists for Pakistan and India*

Attachment II - Annex – 'A' (Pakistan)			Attachment II - Annex - 'B' (SriLanka)		
100% Immediate Concession List			100% Immediate Concession List		
	Total Products 206			Total Products 102	
S#	HS Code		S#	HS Code	
1	03	Fish and crustaceans, molluscs and other acquatic invertebrates [03]	1	07	Edible vegetables and certain roots and tubers [07]
2	07	Edible vegetables and certain roots and tubers [07]	2	08	Edible fruit and nuts; peel of citrus fruit or melons [08]
3	08	Edible fruit and nuts; peel of citrus fruit or melons [08]	3	09	Coffee, tea, maté and spices [09]
4	09	Coffee, tea, maté and spices [09]	4	12	Oil seeds and oleaginous fruits; miscellaneous grains, seeds and fruit; industrial or medicinal plants; straw and fodder [12]
5	12	Oil seeds and oleaginous fruits; miscellaneous grains, seeds and fruit; industrial or medicinal plants; straw and fodder [12]	5	13	Lac; gums, resins and other vegetable saps and extracts [13]
6	14	Vegetable plaiting materials; vegetable products not elsewhere specified or included [14]	6	20	Preparations of vegetables, fruit, nuts or other parts of plants [20]
7	16	Preparations of meat, of fish or of crustaceans, molluscs or other aquatic invertebrates [16]	7	25	Salt; sulphur; earths and stone; plastering materials, lime and cement [25]
8	20	Preparations of vegetables, fruit, nuts or other parts of plants [20]	8	29	Organic chemicals [29]
9	21	Miscellaneous edible preparations [21]	9	39	Plastics and articles thereof [39]
10	25	Salt; sulphur; earths and stone; plastering materials, lime and cement [25]	10	56	Wadding, felt and nonwovens; special yarns; twine, cordage, ropes and cables and articles thereof [56]
11	26	Ores, slag and ash [26]	11	64	Footwear, gaiters and the like; parts of such articles [64]
12	33	Essential oils and resinoids; perfumery, cosmetic or toilet preparations [33]	12	73	Articles of iron or steel [73]
13	34	Soap, organic surface-active agents, washing preparations, lubricating preparations, artificialwaxes, prepared waxes, polishing or scouring preparations, candles and similar articles, modelling pastes, "dental waxes" and dental preparations with a basis o [34]	13	74	Copper and articles thereof [74]
14	35	Albuminoidal substances; modified starches; glues; enzymes [35]	14	82	Tools, implements, cutlery, spoons and forks, of base metal; parts thereof of base metal [82]
15	38	Miscellaneous chemical products [38]	15	84	Nuclear reactors, boilers, machinery and mechanical appliances; parts thereof [84]
16	39	Plastics and articles thereof [39]	16	85	Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television image and sound recorders and reproducers, and parts and accessories of such articles [85]
17	40	Rubber and articles thereof [40]	17	86	Railway or tramway locomotives, rolling-stock and parts thereof; railway or tramway track fixtures and fittings and parts thereof; mechanical (including electro-mechanical) traffic signalling equipment of all kinds [86]
18	41	Raw hides and skins(other than furskins) and leather [41]	18	87	Vehicles other than railway or tramway rolling-stock, and parts and accessories thereof [87]
19	42	Articles of leather; saddlery and harness; travel goods, handbags and similar containers; articles of animal gut (other than silk-worm gut) [42]	19	90	Optical, photographic, cinematographic, measuring, checking, precision, medical or surgical instruments and apparatus; parts and accessories thereof [90]
20	44	Wood and articles of wood; wood charcoal [44]	20	91	Clocks and watches and parts thereof [91]
21	46	Manufactures of straw, of esparto or of other plaiting materials; basketware and wickerwork [46]	21	92	Musical instruments; parts and accessories of such articles [92]
22	48	Paper and paperboard; articles of paper pulp, of paper or of paperboard [48]	22	96	Miscellaneous manufactured articles [96]
23	49	Printed books, newspapers, pictures and other products of the printing industry; manuscripts, typescripts and plans [49]			
24	50	Silk [50]			
25	51	Wool, fine or coarse animal hair; horsehair yarn and woven fabric [51]			
26	53	Other vegetable textile fibres; paper yarn and woven fabrics of paper yarn [53]			
27	55	Man-made staple fibres [55]			
28	56	Wadding, felt and nonwovens; special			

		yarns; twine, cordage, ropes and cables and articles thereof [56]			
29	57	Carpets and other textile floor coverings [57]			
30	60	Knitted or crocheted fabrics [60]			
31	63	Other made up textile articles; sets; worn clothing and worn textile articles; rags [63]			
32	68	Articles of stone, plaster, cement, asbestos, mica or similar materials [68]			
33	69	Ceramic products [69]			
34	70	Glass and glassware [70]			
35	71	Natural or cultured pearls, precious or semi-precious stones, precious metals, metals cladwith precious metal, and articles thereof; imitation jewellery; coin [71]			
36	73	Articles of iron or steel [73]			
37	74	Copper and articles thereof [74]			
38	76	Aluminum and articles thereof [76]			
39	83	Miscellaneous articles of base metal [83]			
40	84	Nuclear reactors, boilers, machinery and mechanical appliances; parts thereof [84]			
41	85	Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television image and sound recorders and reproducers, and parts and accessories of such articles [85]			
42	88	Aircraft, spacecraft, and parts thereof [88]			
43	89	Ships, boats and floating structures [89]			
44	90	Optical, photographic, cinematographic, measuring, checking, precision, medical or surgical instruments and apparatus; parts and accessories thereof [90]			
45	91	Clocks and watches and parts thereof [91]			
46	92	Musical instruments; parts and accessories of such articles [92]			
47	94	Furniture; bedding, mattresses, mattress supports, cushions and similar stuffed furnishings; lamps and lighting fittings, not elsewhere specified or included; illuminated signs, illuminated name-plates and the like; prefabricated buildings [94]			
48	95	Toys, games and sports requisites; parts and accessories thereof [95]			

1. Pre and Post FTA Trade between Pakistan and Sri Lanka

I n 2009 Pakistan's exports at around $17.5 billion were 8.3 percent of GDP. The imports at around $31.5 billion were 15 percent of GDP. The share of Sri Lanka in overall Pakistani exports stood at 1.2 percent. The average tariff bound for all products was 52.4 percent. In case of agriculture and industrial products the rate was 97.1 and 35.3 percent respectively. The average tariff applied for all products was 11.42 percent which indicates that Pakistan is well below its bound limits.

Sri Lanka compared to other South Asian economies liberalized its trade regime much earlier. Recently exports grew largely on account of apparel and agricultural products such as tea. Like Pakistan, Sri Lanka's leading export destination is United States. The share of Pakistan in the overall exports of Sri Lanka stands around 0.8 percent. In 2008 the average tariff bound for all products was 29.8 percent. In case of agriculture and industrial products the rate was 49.7 and 19.3 percent respectively. The average tariff applied for all products was 8.9 percent. In case of agriculture and industrial products the average tariff applied was 28.4 and 7.4 percent respectively. In comparison to Pakistan, Sri Lanka's applied rates are higher for agriculture and lower for industrial products.

Traditionally the trade volume between Pakistan and Sri Lanka has remained low; The balance of trade between the two countries is in favour of Pakistan, increasing annually every year since 2002. Pakistan's exports to Sri Lanka increased from $76 million in 2003 to $216 million in 2009. The total export value between 2003 and 2009 stood around $1120 million. The highest percentage share of

export to Sri Lanka in overall Pakistani exports was seen in 2007 at around 1.2 percent (when Pakistan's total exports were $16.9 billion).

On the other hand Sri Lanka's exports to Pakistan increased from $28.8 million in 2002 to $54.7 million in 2009. The highest percentage share of exports to Pakistan in overall Sri Lankan exports was observed in 2006 at 0.86 percent. The total value of exports to Pakistan between 2003 and 2009 was around $359 million. The overall exports of Sri Lanka did show an impressive growth during this time period, increasing from $4.7 billion to $7.1 billion in 2009.

We now compare the tariffs applied (2009) by Sri Lanka on imports from Pakistan and from leading partner i.e. US reveals that even after FTA, applied tariffs were still on the higher side for Pakistan in case of food and beverages (36 percent with 255 tariff lines), footwear and headgear (22.3 percent with 53 tariff lines), animal and vegetable fats/oils (15 percent with 57 tariff lines), and animal products (12.8 percent with 281 tariff lines). An overall sectoral comparison reveals that Pakistan faced an average applied tariff of 10.73 percent compared to 15.06 percent of US in agricultural products. For industrial products average applied tariffs was 4.3 percent for Pakistan compared to 6.78 percent on goods from US.

Similar to Sri Lanka's case we compare tariffs applied on imports from Sri Lanka and US. The tariffs still remain on the higher side for: a) transport equipment (35 percent with 287 tariff lines), footwear and headgear (19.3 percent with 53 tariff lines), food and beverages (13.8 with 229 tariff lines), animal or vegetable fats/oils (16.29 percent with 54 tariff lines), animal products (8.9 percent with 248 tariff lines). The similarities between the still relatively restricted product groups are representative of similarities in the product structure of the two countries. An overall sectoral comparison reveals that Sri Lanka faced an average applied tariff of 6.3 percent compared to 13.7 percent by US on agricultural products. For industrial products average applied tariffs was 6.7 percent for Sri Lanka compared to 11.5 percent for US.

Despite Sri Lanka and Pakistan not being major trading partners, their respective export markets are crucial. For example, Pakistan is an important export market for tea, followed by copra, rubber, betel leaves and tamarind. Similarly, for Pakistan, Sri Lanka is an important market for textiles, pharmaceuticals, machinery and agricultural items. All major Sri Lankan export sectors have been granted preferences in the FTA. For example this agreement allows

duty free entry for 10,000 tons of tea per year and Pakistan happens to be the third largest tea importing nation in the world.

We now see the changes in product group shares for Pakistan's import from Sri Lanka (Table 1). The product group with the highest weight sees a decline between the period 2003 to 2008. The import of vegetable products had a percentage share of 63.8 percent (in overall imports of Pakistan from Sri Lanka) in 2003 which declined to 46 percent in 2008. On the contrary, rubber and plastics group had a share of 21.1 percent in 2003 which increased to 40.4 in 2008. Other products whose shares increased during the period include: textiles (from 3.4 percent in 2003 to 4.7 percent in 2008), wood and wood articles (from 1.0 percent in 2003 to 2.6 percent in 2008). These are also complimented by sectors presently not having a large share in the overall imports. To some extent it can be claimed that as a result of this FTA the exports of Sri Lanka increased for non-traditional exports.

We can also observe the overtime change in product group shares for exports of Pakistan to Sri Lanka (Table 2). The textile articles having the largest weight in Pakistan's exports to Sri Lanka registered an increase in export share from 50.7 percent in 2003 to 59.5 percent in 2008. Other groups whose share increased include: vegetable products (increasing from 18 percent in 2003 to 19.8 percent in 2008), prepared foods and beverages (increasing from 1.5 percent in 2003 to 2 percent in 2008), base metals (increasing from 2.8 percent to 5.7 percent during the same period). Minor increases were also seen in the shares of machinery and appliances, pulp, paper and paper board. The product groups whose shares decreased include live animals, animal products, chemical products, rubber, plastics, and footwear.

For Sri Lanka's exports we see some change in the value terms as regards the importance of individual sectors. The vegetable products remained on top in the pre and post FTA period followed by plastics and rubber, textiles and textile articles. However base metal which out of all product groups had 4th largest share in Sri Lanka's total exports to Pakistan slided to 9th position. Similarly the machinery and appliances group declined from 5th to 7th in ranking. The chemical products that stood 6th in pre FTA ranking came 5th in post FTA milieu. The wood and wood articles had 9th position earlier which improved to 4th in the post – FTA period. The mineral products improved from 10th to 6th in the overall ranking.

In case of Pakistan textile's share in Pakistan's exports to Sri Lanka remained on top, followed by vegetable products. The live animal and animal products group was 3rd before the FTA however

slided to 5th by 2008. The chemical sector maintained its 4th position. The plastics and rubber group slipped from 5th to 7th. The exports of base metals improved and its ranking in export shares increased from 6th to 3rd.

2. Process Analysis: Pakistan-Sri Lanka FTA

There are many steps involved in an FTA process. The first step before any two parties sign a FTA is to investigate whether the FTA between partner countries is feasible in form of a detailed feasibility report. Each partner country may undertake its own feasibility study comprising of a detailed analysis of the partner country's macroeconomic potential, development patterns of different sectors which may be relevant for the FTA, its trading profile including any barriers to trade and its key trading partners. The second step in an FTA is to reach out to the Industry stake holders and to understand the key issues which may be relevant in formulising the FTA to the benefit of the home country and its industry. Then comes the actual negotiations where important factors of success are the very management of the negotiations through well represented team, utilisation of all the relevant communication channels of awareness and by actively developing different scenarios to be presented to the partner's table. After negotiations comes FTA implementation, where key aspects are the formulation of viable and effective communication strategy to advertise to the masses regarding the FTA and any trade facilitating measures which are important in smooth implementation of the agreement. Last step in a FTA process is to assess the economic and social costs and benefits of FTA . The last step comprises of an empirical study which analyses the extent of trade creation and diversion in the economy due to the FTA. As discussed above, the five steps in an FTA process is as follows:

   1)   Feasibility

2) Internal Analysis and Industry Outreach in Pakistan
3) Negotiations
4) Post Negotiations
5) Economic and Social Cost Benefit Evaluation of the FTA

The effectiveness of the FTA can be gauged through this process. Here we would evaluate Pakistan Sri Lanka FTA . The documents which are utilised to assess whether Pakistan Sri Lanka FTA followed the 5 step process is as follows:

- Summary of a Feasibility Study
- Inter-ministerial Communications
- Summaries to the Cabinet regarding FTA
- Communications with the Pakistani High Commissions (Sri Lanka, India)
- Communications with Sri Lankan High Commission
- Communications with the Private Sector
- Newspaper Articles
- PITAD Impact Evaluation Study

Phase 1: Feasibility
Assessing the overall economic situation of Sri Lanka
Domestic policy

The summary of the feasibility study concludes that Sri Lanka is the richest and fastest growing economy when compared to Pakistan, India and Bangladesh. However, it is not clear from the summary whether the conclusion has been drawn from the hard data and country comparisons of GDP growth rates, fiscal situation, capital market performance, inflationary trends, human capital indicators, poverty and inequality profiles etc

Sectoral Analysis

Before signing an FTA, a detailed sectoral analysis is important to pin point which sectors are most relevant for Sri Lankan economy vis a vis their productivity. For example, Pakistan intends to export semi manufactured and agricultural goods to Sri Lanka after the FTA to improve its export base. Sectoral analysis is absent in the summary of the feasibility study. Certain products are identified which are of Pakistani interest but the summary couldn't substantiate the basis for selection other than their relevance based on their import demand for Sri Lanka.

FDI and Investment Policy

According to the summary of the feasibility study Sri Lanka has the highest FDI (as a percentage of GDP). MOC documents suggest that that both countries would facilitate investment opportunities post FTA. A fear regarding Indian Investments into

Sri Lanka was raised especially in auto sector. By opening a plant in Sri Lanka and employing 35% of domestic resources, India may also fulfill rules of origin criterion and would be in a position to export to Pakistan via Sri Lanka with reduced duties. This may adversely affect Pakistani Auto Industry.

Sri Lanka has the most liberalized investment regime in South Asian region. Sri Lanka is the regional trading hub with one of the best ports in the region. Sri Lanka has transparent investment laws with investment protection agreement. There is ample possibility for expansion of trade and establishment of joint ventures between Pakistan and Sri Lanka in agro based products including sugar production, sea food processing; value added textiles and garments; tea and its plantation, electronics; metal fabrics and light engineering, pharmaceutical products; dehydration, preservation and canning of fruits and vegetables etc.

Pakistan and Sri Lanka are lucrative destinations for exporters of both countries as on the one hand Pakistan is a gateway to resource rich Central Asian states while on the other hand Sri Lanka enjoys duty free access to huge European Union and Indian markets.

Trade and tariff profile of Sri-Lanka

Before signing an FTA it is important to understand existing tariff structure of Sri Lanka in all products it imports from rest of the world. Such an analysis may tell how Pakistani products may have comparative advantage over other exporting partners of Sri Lanka through reduction of tariffs once FTA is in place between both the countries. Trade and tariff profile is absent in the summary.

Trade Barriers

The summary suggests that the feasibility undertaken by MOC does not cover the nature of trade barriers that are prevalent in Sri Lanka. However it concludes that Sri Lanka's import tariffs are lowest in the world.

Identifying Other Key Trading Partners

A product list is devised in the summary based on their overall import demand in Sri Lanka. Following products were identified for preferential treatment:

1. Fish and Preparation
2. Edible Vegetable
3. Edible Fruits
4. Spices
5. Cereals mainly Rice
6. Tobacco
7. Salt/ Sulphur

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8. Plastic and Articles
9. Pearls and Articles
10. Pearls/Precious Stone
11. Iron and Steel
12. Cutlery
13. Electrical Machinery

The above mentioned list comprise of 41% of Sri Lankan imports. 40% of Pakistan exports fall under this category of products however Pakistan share in Sri Lankan imports of this category of products is only 4%. This means that Sri Lanka is importing from other countries and once FTA is in place, Pakistan will be able to export more to Sri Lanka. The discussion in the summary does not extend to identify the key trading partners of Sri Lanka in these products who are direct competitors of Pakistan. For example, MOC documents suggest that India is one of the important trading partners of Sri Lanka as both countries have also signed an FTA. Furthermore, PITAD document on 'Pakistan Sri Lanka post FTA analysis' identifies that EU and USA makes up for the major export destinations for both Pakistan and Sri Lanka. One can infer that through an FTA Pakistan and Sri Lanka can have more intra industry trade to enhance competitiveness and productivity of their products to be exported to USA and EU. However the feasibility study fails to cover this aspect.

Structure of Tariffs

The summary promotes zero duty concessions on exports from Pakistan on following items:
1. Fruits and Vegetables
2. Spices
3. Vegetable and Synthetic Fibre
4. Crude Minerals
5. Gascous Hydrocarb

While gradual phasing out in 3 to 5 years is proposed on items which cover
6. Tea
7. Crude Rubber
8. Pigments and Paints
9. Rubber Manufactures
10. Betel Leaves

MOC summary to the Pakistani Cabinet dated July 2000 suggests that both sides should consider gradual phasing out of preferential duties ranging from 100% to 25% on items to be negotiated. The document identifies that major items for tariff concessions to be requested by Sri Lanka are tea, natural rubber, coconut pulp, betel leaves/nuts, spices, sugar products, waste

paper, textile, yarn and made ups, metal fires and soap, while Pakistan's list for seeking concessions may include cotton, rice, yarn, cotton fabrics, synthetic textiles, fish, fruits and vegetables, sugar products, pharmaceutical products, leather, surgical instrument, sports goods and some nontraditional items of exports such as gems and jewelry etc.

International Trade Law Compliance

Since FTAs come under the rules and regulations adopted by WTO, international trade law compliance is necessary to fit with GATT (General Agreement on Tariffs and Trade). For example Articles XX and XXI will be evoked for the protection of national security, protection of public morals, protection of human, animal or plant life and health and the protection of artistic, historic and archeological value. The FTA also provides for the contracting parties to apply their domestic legislation to restrict imports in cases where process are influenced by unfair trade practices like subsidies or dumping as is provided by GATTs and the relevant WTO Agreements.

Rules of Origin

The summary of the feasibility study does not provide any guide line for the rules of origin. MOC documents show that there were at least 3 proposals for establishing the origin of content criterion is concerned. Pakistan proposed that ROO should be based on SAPTA i.e., there should at least be 40 % value addition if the product is not wholly produced in the exporting country. Sri Lanka insisted on 25 % where as it was decided to be 35 % which is the same as Sri Lanka has agreed with India.

Assess the Trade Data for Sri Lanka
Trade Volumes and Trade Structure

The summary report does not analyze the overall trade volume or trade structure of either Pakistan or Sri Lanka.

Main Exports and Imports

It is important to analyze main imports of Sri Lanka to see whether Pakistan can benefit through the FTA by reduction in tariffs in products which comprise of Sri Lanka's main Imports. The summary of the feasibility identifies major imports of Sri Lanka comprising of textiles, cereals, electrical machinery, vehicles, mineral fuels and oils. Sri Lanka's major exports comprise of readymade garments (50%), tea, rubber, and pearls.

Pakistan's Exports and Imports

Since Sri Lanka is only a small trading partner with only $100 million trade with Pakistan when the talks on FTA was initiated, Pakistan's total exports and import profiles were not present in the

feasibility study. Other documents do not mention Pakistan's Exports and Imports profiles other than what is exported or imported to Sri Lanka. Though auto industry exports are discussed by private sector stakeholders in order to protect their businesses domestically incase Indian exports in the sector find their way into Pakistan through the FTA. A fear resolved by stringent application of rules of origin as proposed by MOC.

<div align="center">

Trade Balance

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It appears that there is tacit understanding during FTA negotiations that structure of trade balance between Pakistan and Sri Lanka would not change drastically but FTA is expected to bring new trading opportunities for both countries. A two year long FTA formulation especially regarding tariff regulatory quotas on tea, betel leaves for Sri Lanka and Rice, Onions for Pakistan in addition to tariff phasing out on nearly 4000 product lines from both sides by year 2008 would definitely determine significant changes in trade balance.

Global Supply chain Environment for major export products

Liaison with Industry Representative

The summary suggests that the feasibility study does not reach out to Industry representatives of both Countries but other documents show that MOC, Pakistan did made an effort to undertake meetings with Industry stakeholders where the major concern was India Sri Lanka FTA and need of signing FTA with Sri Lanka. There were some concerns by Industry representatives especially from auto sector in Pakistan.

Structure of Inputs used in Exporting Products

Rules of Origin designed by MOC, Pakistan incorporate the possibility of trade in manufactured products e.g. auto industry especially of Indian Origin. Structure of inputs and their origin are to be determined before trade can happen between Pakistan and Sri Lanka under an FTA.

There is also a possibility that exporting sector in Pakistan use imported inputs also from Sri Lanka. However, according to the summary such possibilities are not covered in the feasibility.

Tariff rates on these Inputs

It is important to analyze tariff rates on importing inputs. If the FTA covers inputs which represent imports from Sri Lanka, this may have an application for domestically produced inputs. Summary does not substantiate that such analysis is carried out in the feasibility.

Imported Inputs for Export versus Domestic Consumption

Post FTA, increase in intra industry trade would enable both countries to import cheaper inputs for exports in manufacturing sector. However FTA documents do not cover this aspect.

Review Previous Cooperation Efforts between Pakistan and Sri Lanka

Benefits Derived From Other Agreements Signed Previously

There is brief mention of SAFTA. Pakistan Sri Lanka FTA has been seen to pave way for the success of SAFTA.

Benefits that can be added in the further Negotiations

During the formulization of the Pak-Sri Lanka FTA, Pakistan showed increased understanding of the benefits accrued for enhanced regional trade and foresees the possibility of further FTAs and eventually a successful implementation of regional model of trade under SAFTA. However feasibility report does not cover this aspect.

Bilateral Issues between the FTA Partners
Current Issues that have been discussed between the Pak-Sri Lanka

The very rational of FTA between Sri Lanka and Pakistan does not come out of economic rational but as a realization of close bilateral ties between both countries where Pakistan has been accepted as a time tested friend of Sri Lanka by its government and press. Pakistan was instrumental in helping out Sri Lanka in resolving internal conflict in the country as well as aiding the country through natural calamities like Tsunami or offering technical assistance in number of projects through allocating generous credit ($ 5 million in 1991 and $10 million in 2003) as well as tapping in the tourist industry for both countries.

Barriers faced by Pakistani Exporters

There can be Non tariff barriers which are faced by Pakistani exports in Sri Lanka. However, the summary of the feasibility does not discuss this.

Phase 2: Internal analysis and industry outreach in Pakistan
Assessment of Export Priorities

Export Competitiveness by using RCA's and UEP

Export competitiveness analysis is important to pin point such products where Pakistan or Sri Lanka can export to each other efficiently. This may be done by calculated Reveled comparative advantage and unrealized export potential index. PITAD document on Pakistan Sri Lanka FTA impact evaluation carry out the

analysis and list down products where Pakistan and Sri lnaka have comparative advantage over each other.

Assessment of Import Sensitivity
Structure of Products with High Applied Tariffs

Industry stakeholders through communication with MOC identify auto sector to be having high applied tariffs in Sri Lanka and is also in the negative list of the country in the FTA. However, it is in the concession list of Pakistan. They fear that this will encourage flow of auto sector imports from India via Sri Lanka. However, according to MOC, rules of origin ensure that such would not happen as Sri Lanka has no auto manufacturing industry.

Assessment whether any items are sensitive

A sensitive list is prepared by Pakistan. There is some controversy on the inclusion of entire auto sector in the sensitive list.

Identifying Industry Interest and Concerns regarding the FTA

Stakeholders' communications with the MOC shows that manufacturing sector has concerns over the FTA.

- A)Engineering Development Board wants items of Chapter 87 (piston engines) to be included in sensitive list
- B) Pakistan Auto Manufacturers Association wants all the preferential items of auto sector to be included in the negative list
- C) Atlas Rubber and Plastic Industries want import of PVC compound (HS code: 3904.2200) from Sri Lanka be checked as Sri Lanka does not produce this category of Products

Compliance Costs

A) Reviewing Environment, labor and Product Standards
B) IPR Issues

It appears that Compliance costs were least of the concerns in the FTA partly because both countries are developing countries. However such costs become a major aspect of the FTA if it is seen under WTO rules and regulations.

Revenue Impact: Loss of revenue due to preferential tariffs

Annual Revenue Loss on Imports from Sri Lanka
- Tea Leaves = Rs 96 million
- Betel Leaves= Rs 11.25 million

Phase 3: Negotiations
Know Your Partner Constraints

Initially Sri Lanka did not conform to Pakistani proposal to give tariff rate quota on Rice, Potato and Onion. After 2 years of active negotiations eventually market access has been provided to Pakistan in the said products by year 2005.

Develop Scenarios

Both Concessions list and non Concessions list has been changed multiple times during 2 years of FTA negotiations between Pakistan and Sri Lanka which suggests that active scenario building took place while formulating the details of the agreement.

Management of Negotiations

A) The team for FTA negotiations comprised of relevant people.
B) Communication Channels remain poor as relevant trade bodies were not directly involved
C) Negotiation Sessions were managed well
D) Lists were exchanged so several iterations were involved

Phase 4: Post negotiation / implementation
Formulating a Viable and Effective Communication Strategy

Post FTA, the government should adopt an effective communication strategy whereby traders and relevant people are informed in detail regarding the FTA so that maximum benefits are accrued. However, the Communication strategy has been undermined by the fact no seminars, conferences and public events were organized. Public awareness was generated through news paper advertisements which was not enough

Trade facilitating Measures to Implement the FTA

No Targeted trainings have been carried out which is very important for the success of FTA process. For example MOC documents show that one of the reasons why India Sri Lanka FTA is not effective is due to the stringency of customs staff who are not trained to effectively implement the FTA.

Trade Analysis Impact (Trade Creation and Diversion)

PITAD carries out a detailed impact evaluation study to analyse trade creation and diversion as an outcome of the FTA. Please find the details in coming lines.

3. Methodology and Data

In this book we use a multi-pronged approach in order to evaluate the impact and potential of Pakistan – Sri Lanka FTA. Our approach uses descriptive analysis (seen in previous section), competitiveness and complimentary (indices based) analysis, general equilibrium impact, and calculation of total trade effect. We list these methodologies below and highlight their comparative advantage in evaluation of FTA. This is followed by results from a perception survey of exporting and importing entities in Pakistan.

- Analysis on direction of pre and post – FTA trade
- Using trade indices in order to evaluate competitiveness and complementarities.
- Global CGE model (GTAP[11]) used to see the general equilibrium effects of FTA on Pakistan, Sri Lanka and rest of the world
- Using WITS-SMART model based on UNCTAD-TRAINS database to see the trade diversion / creation effects
- Conducting a perception survey of various stakeholders

At this point we may justify here the use of GTAP methodology which is used in order to see the potential general equilibrium impact of PSFTA. The GTAP consists of: a fully documented, publically available, global data base; a standard general

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[11] Global Trade Analysis Project (GTAP).

equilibrium modelling framework; and software for managing the data and implementing the standard model. For a detailed description see Hertel (1997).

The GTAP data base derives Pakistan's data from Social Accounting Matrix (SAM) prepared in Dorosh *et al.* (2004). The benchmark year in this SAM corresponds to the fiscal year 2001-02. The data sources of this SAM include a 97 sectors Input – Output table for Pakistan, value added for 15 sectors from national accounts data, household consumption data from Pakistan Integrated Household Survey, household income disaggregation from Pakistan Rural Household Survey and data on production, prices and trade from the annual publication of Ministry of Finance - Pakistan Economic Survey. For Sri Lanka the GTAP data base derives information from Input – Output table for Sri Lanka. The benchmark data for this table corresponds to 2000. See Jeevika (2008) for details.

The System of Market Analysis and Restrictions on Trade (SMART) a partial equilibrium model is a fully integrated module in World Integrated Trade Solutions (WITS). This model is used to simulate the partial equilibrium impact of a tariff reduction for a single market[12]. WITS by default allow the user to access data from COMTRADE[13], TRAINS[14], IDB[15] and CTS[16] datasets.

A perception survey was carefully designed to take in to account the stakeholders' views. Separate questionnaires were designed for exporters, importers and trade organizations. Most of the exporting firms interviewed were also producers and employed over 1500 employees with at least 5 percent of their total exports destined for Sri Lanka, for at least 5 years including the pre and post FTA period.

Competitiveness Analysis

For competitive analysis we use disaggregated commodity-wise imports and exports data since 2003. The data available for such an analysis has certain limitations. For example the import and export data (disaggregated at HS-8 level) available for Sri Lanka (at the time of this study) was up to 2005 however for our analysis the

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[12] See: [Retrieved from].

[13] The Commodity Trade (COMTRADE) Data Base contains exports and imports by commodity and partner country. The Data Base includes information for over 130 countries

[14] The Trade Analysis Information System (TRAINS) contains information on imports, tariffs, para-tariffs and non-tariff measures for 119 countries.

[15] The WTO's Integrated Data Base (IDB) contain imports by commodity and partner country and MFN applied tariffs for over 80 countries at a detailed commodity level.

[16] The Consolidated Tariff Schedule Data Base (CTS) contains WTO bound tariffs, Initial Negotiating Rights (INR) and other indicators.

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post-FTA analysis would optimally require data for 2008[17]. Since data for Pakistan's imports is available up to 2008 it was easy to use it as mirror data for unavailable period of Sri Lankan goods. The mirror statistics provide only a second-best solution, and need to be corrected in order to account for transhipment and inversion of reporting standards. The control totals are derived from UN COMTRADE database.

To analyze specialization levels of both countries trade specialization index (TSI) is used. The differences in the level of technology and human capital and the pursuit of economies of scale can lead to intra-industry trade even in products with identical factor input requirements. In order to check where there exists potential for intra-industry trade Grubel Lloyd Index (GLI) is used. Last but not least for country-wise comparative advantage at the product - level Revealed Comparative Advantage (RCA) index is used. In this section due to availability of data, greater explanation is found for Pakistan's case.

G-L Index

This index ranges between zero (inter-industry trade) to one (intra-industry trade). In Table 3 we report Pakistani and Sri Lankan products having highest G-L index at HS-2 commodity classification. For Pakistan, among the top commodity groups with significant intra-industry trade potential are: articles of ores slag and ash, fruits and nuts, tobacco, jewellery and precious stones, tools and cutlery of base metal, ropes and cables, headgear and other parts, ships and other floating structures, and man-made staple structure.

In contrast, intra-industry trade potential of Sri Lanka exists: in copper articles, stones, tobacco, precious stones, animal products, antiques and other art pieces, ceramic products, animal feed, miscellaneous edible preparations and mattresses and quilts. The intra-industry trade can provide new basis for enhancing bilateral trade between Pakistan and Sri Lanka. The prospects of vertical integration can flourish trade even between the countries that lacks strong complementarities (see Yeats, 1998).

Trade Specialization Index

The index varies between -1 (high import specialization) and 1 (high export specialization). We may observe the TSI of Pakistan computed at HS2 commodity classification and the change that

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[17] We used the data base on Sri Lanka's tradable goods maintained by UN Comtrade.

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occurred between 2003 and 2007. Most of the top products stood their ground over a period of time while maintaining specialization. The group of products holding ground before and after the PSFTA oscillates in a very narrow range while the rest of commodities either gained or lost their positions. Table 4 show products in which Pakistan substantially gained including iron and steel, live tress plants, bulbs, aluminum articles, salt, sulphur, earth, lime and cement, manmade staple fibers, optical and photo, mechanical apparatus, impregnated and laminated textile fabrics, inorganic chemicals, precious metal compound and glass and glassware.

Table 5 shows the list of products in which Pakistan to some extent lost specialization over the same period that includes albuminoids, modified starches, glus and enzymes, cereal, flour, starch and milk preparations, carpets and other textile floor coverings, articles of apparel and accessories.

Revealed Comparative Advantage (RCA)

An index value of RCA > 1 implies comparative advantage and RCA < 1 implies comparative disadvantage in exporting a specific product. Pakistani exports exhibiting strong RCA are mainly concentrated in the textiles, clothing, electrical equipments consisting of sound recorders, telecommunication equipments, and nuclear reactors, boilers and mechanical appliances and to a lesser degree in usually expected value added products. At HS-2 level Pakistan's RCA is low in base metals, machinery, mechanical appliances, optical and cinematographic apparatus and travel goods.

Almost all Pakistani products at the HS-2 level, having higher bilateral RCA with Sri Lanka in terms of trade volume enjoy static comparative advantage. Highest comparative advantage lies in electrical machinery and parts containing recorders. Out of the 1000 products calculated at HS-4 level for bilateral RCA, almost half of them enjoy static comparative advantage whereas the dynamic comparative advantage of Pakistan over Sri Lanka is

possessed by few products mainly in sugar, confectionaries, pharmaceutical, spices and some vegetables products.

The Pakistani products with static comparative advantage (in year 2007) over Sri Lanka include: agricultural products (meat; fish; dairy produce; vegetables; cereals; lac and gums, milling industry products; sugar and sugar confectionaries; fruits; tobacco), mineral products (ores; salt; sulphur; stone), chemicals and pharmaceuticals(organic/inorganic compounds of precious metals, plastic and plastic products, photographic goods), leather (raw hides and skins, leather products, handbags), textiles (cotton yarn & fabrics, knitted fabrics, textile made-ups, clothing accessories; hand-made fabrics; special yarns & ropes).

Survey Results

A detailed perception survey was carried out which included exporting and importing entities mainly from Pakistan. The stakeholder perceptions were sequenced in three different questionnaires designed for: exporters, importers and trade organizations. We now look at the sector-specific responses below.

Exporters

While most firms reported some level of familiarity with PSFTA and recognized its importance for their future business. They however complained about the lack lustre role of public sector in creating awareness about the FTA. One of the main reasons cited for non – utilization of this FTA opportunity was the difficulty in obtaining certificate of origin. The average time taken for exporters for each stage that included: obtaining export codes, acquiring and revalidation of licences, processing of shipping bills, obtaining refunds, customs clearances, and final dispatch of export consignment, was around 10 days which is higher in comparison to competitor economies such as China and East Asia.

The exporters in yarn and fabric reported that many Sri Lankan importers place their orders with local bank guarantees which are difficult to obtain in Sri Lanka. This in turn forces the exporters not to take the risk and enter into the transaction. Several occasions were reported where Sri Lankan importers have yet to honour the accounts payable since the past 6 months (after the delivery of consignment). The fabric sector reported an average of mere 0.3 percent increase in export receipts in the post – FTA period. There is a need to further increase coordination between; a) trade associations of Sri Lanka and Pakistan, and b) governmental trade bodies of the two countries. This sector also expects rising competition from China and India in future for which increased government support is required.

The spinning and weaving enterprises interviewed had an average of 7 to 8 percent exports to Sri Lanka before the signing of FTA which has now decreased to 6 percent. This according to the respondents is due to a host of factors including an FTA which Sri Lanka has signed with India. The domestic regulatory requirements in Sri Lanka were termed complicated which ultimately act as non tariff barriers. Increased effort is required on part of Sri Lankan government trade bodies in order to create awareness about FTA with Pakistan and to help in illuminating domestic importers regarding the superiority of Pakistan's weaving industry over other regional competitors. The sea freight companies have long been overcharging. There is also a need to increase the frequency of sea vessels.

The enterprises dealing in leather were found very familiar with the terms and conditions laid out in the PSFTA. Those interviewed had an average 13.5 percent of their total exports destined to Sri Lanka and most of them had branches abroad. However no changes were reported in the share of exports in the pre and post FTA period. It was asked that Government should initiate its trade related diplomatic efforts with Sri Lanka in order to ease the strictness observed regarding the acquiring of certificate of origin. It was further emphasized that even errors related to punctuation cost greatly in the form of Sri Lanka charging penalties.

The enterprises falling in the category of food, beverages and tobacco reported an average 13 percent increase in their share of exports to Sri Lanka after the FTA. Apart from the concessions allowed under the immediate concession list of Sri Lanka the increase in food exports are also attributed to increased per capita incomes in the country and a projected rise in demand for future. This industry has however been facing increasing domestic costs owing to a general rise in container and handling charges in Pakistan. The items perishable in nature are required to be on the shelf with in a stipulated time period decided upon at the time of placement of import order. Any transportation related delay costs dearly not only to the importer but also to the exporter in Pakistan who fails to comply by the food packaging and handling requirements.

The iron, steel, and metal products enterprises reported no change in their share of exports to Sri Lanka after FTA. This sector asked for a more aggressive effort on part of Trade Development Authority of Pakistan (TDAP) particularly as far as execution of initiatives such as foreign exhibitions is concerned. This sector was also due to gain from liberalization under SAFTA which however did not materialize in the manner in which it was earlier envisaged.

There also exist prospects for regional vertical integration in this sector. The respondents felt that there is a need to lessen the burden of documentation on this sector. The various data clearance and supportive text materials required at the ports, airports, border crossing points and other official clearances inside Sri Lanka increase the costs to exporters.

The chemical and chemical products sector has been included in the immediate concession list of Sri Lanka. The respondents from this sector particularly those dealing in Benzene and Toluene reported no increase in the share of exports to Sri Lanka in the post FTA milieu. The main reasons for this sector in not utilizing the provision provided under the FTA include: a) Sri Lanka being a very small market, and b) difficulty in obtaining certificate of origin. Like the food and beverages sector this sector has special container and packaging requirements which in Pakistan are faced with rising costs and declining infrastructure. The Federal Board of Revenue (FBR) had previously been charging excess duty from this sector and it was decided in legal decree that FBR will refund the excess amount. However it took almost two years for the FBR to execute these court orders which cost the producers and traders in this sector dearly.

On the production side exporters were concerned about the rising input costs, excessively regulated markets and lack of standard information and information about changes in rules. In the textile sector, respondents who are producers as well as exporters reported closure of production units and factories due to the above mentioned issues. Major problems were also reported in case of moving freight with in Pakistan. The costs of railways and road transport were termed high in comparison to regional countries including India and Sri Lanka.

The occasions that included container vehicles were also termed risky in terms of the timely delivery of consignments. In sea transportation, with only one gate at Port Qasim, perishable items are often vulnerable for not meeting the quality standards desired by the importers particularly when under this FTA there is a limit of 40 containers only. The Karachi port electronic care system was termed frustratingly slow. Rice stands exempted from customs care system, and it was felt by the respondents that other perishable items in the food category should also be exempted with a view to improve the shipment time of consignment and avoid unnecessary delays.

In order to lessen the incidence of above mentioned costs, the small and medium enterprises in the textile sector tried to enter in joint venture with foreign firms that included investors from Dubai,

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China, and Bangladesh amongst other countries. This was also accompanied by a drive towards mergers in order to achieve some financial consolidation. However the prospects of joint ventures dried out in the wake of global financial crisis and there were no investment guarantees provided by the Government that could have reduced the risk factors and saved the future export prospects. Several exporters also reported financial loss due to non repayment of accounts receivables amid the liquidity crunch faced by foreign buyers.

Importers

Most of the importers interviewed while expressing a fair level of familiarity with the terms and conditions of this FTA stressed upon the need to create increased awareness about this FTA and observed that it will lead to increased trade volumes in future. They however stressed on the need to lessen the time required for filing of documentation and related paper work. The average time taken for each stage including: obtaining import codes, licences, processing of shipping bills, obtaining refunds, and customs clearances, comes to around 3 weeks.

The Pakistani importers in the food and beverages sector reported a 2 percent decrease in imports from Sri Lanka in the post – FTA period. The respondents felt that tariff preference in FTA is too small. The transport sector firms in Sri Lanka are still not properly equipped due to which occurrences of mishandling are common from warehouses to ports. The climate conditions of Sri Lanka also have a role to play in the decrease in imports. The transport firms do not properly safeguard food items against humidity which ultimately reduces the shelf life of consignments. One of the respondents reported a recent loss of 3 containers in which millions worth of consignment was lost due to moist copra. The efficiency of FTA is also lost to some extent when smuggling goes unchecked. It is has been reported that copra is being smuggled from India through Kashmir border. While it is being imported from Sri Lanka at Rs 3600 per 40 kilograms, the smuggled copra from India finds entry at Rs 2800 per 40 kilograms (without custom duty)[18].

The respondents from palm oil sector asked for increased interaction and coordination between trade bodies, Ministry of Commerce and importers in order to address the grievances of importers in this sector. There is an increased need for prior inspection and specimen validity at Sri Lankan ports and there

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[18] This position has been reported for 2009.

should be a third party supported by Government in order to help, support and facilitate all along the completion of transaction.

The rubber and plastics product sector reported an increase of 5 percent in imports in the post – FTA period, however still asked for removal of certain items of this sector from the negative list. Many non – registered entities are involved in the import operations of this sector. There is an immediate need to only allow registered importers to operate and enjoy preferences under the FTA. The sector is charged a comparatively high sales tax rate at the import stage. Currently there is a no sales tax on this sector's imports in Malaysia, Indonesia and Vietnam which therefore become more lucrative business destinations for Sri Lankan exporters. Instances were also reported where due to low levels of checks and balances; substandard rubber was exported by Sri Lanka in violation of the consignment orders. In this regard it was suggested that trade offices aboard should play an instrumental role in registering protests with local trade bodies. Similar reservations were observed from respondents from tyre, tube, and bicycle traders who reported no change in their import volume in the pre and post FTA period.

In the electrical and electronic equipment sector, importers reported an average of around 5 percent increase in their imports from Sri Lanka since 2005. The respondent informed that although the number of documents has decreased, there still exit complex filing requirement in the remaining documents. There is a need for increased simplification on part of both Sri Lanka and Pakistan. Increased trade diplomacy may also be required to decrease the items in negative list. For example in case of electrical imports while sockets are covered under FTA's immediate concession list, switches are not. Given that both these items are complimentary goods in many cases, there is ultimately very little decrease in preferences. The language used in FTA has been termed difficult in many cases.

The chemical and chemical products sector reported an average increase of 15 percent since the signing of FTA with Sri Lanka. However in this sector the freight forwarding companies are not as efficient as desired. The movement of several chemical products requires complete insurance against physical risks. However the documentation related to insurance is difficult to understand and complex to comply with. At times when urgent orders cannot be entertained through sea transport due to the low frequency of vessels and therefore expensive means such as air transport are used which ultimately add to the overall product cost thus making it unattractive for the importer. There is also a need for improved

customs facilitation, pre and post delivery checks at the port and at the same time facilitating better storage facilities at the port.

Trade Organizations

The various trade bodies / offices interviewed in Pakistan included: TDAP, Karachi Chamber of Commerce and Industry, Lahore Chamber of Commerce and Industry, Pakistan Commodities Importers and Traders Association and Counsel General of Sri Lanka. The FTA was perceived as a success for Pakistan as its exports to Sri Lanka increased. It is felt that Sri Lanka is an emerging market and Pakistani exporters must explore further possibilities to increase their market share. While trade counselling and facilitation is underway from both sides, there is however an increased need to improve the dispute settlement mechanism for which both Governments are also required to increase coordination of their relevant trade organizations. The arbitration process remains slow and related fees are high. The role of advocacy within the private sector cannot be ignored. The various trade associations need to arrange awareness programmes tailored according to their own needs for their members. The Government may in this regards play a supportive role.

The chambers of commerce and industry reported that there still remains a need to reconsider the tariff lines under this FTA. There is a need to increase the tariff lines for Pakistan which will require some future renegotiation. The Government should set up a facilitation bureau with regards to the operations under regional agreements. The chambers were not brought on board for a comprehensive consultative session during the days leading up to the final negotiation of this FTA. In future the negotiation team sent by the Government should include representatives from the private sector (producers, exporters, and traders). The state carrier Pakistan International Airlines (PIA) does not operate regular flights to Sri Lanka in all seasons. The issues of medium to long term visas need to be addressed by the foreign office on both sides.

From the Sri Lankan side the FTA has been termed a general success however there were some complaints on account of Pakistan not fulfilling its obligations in certain spheres. For example it was reported that coconut oil is still placed on the negative list where as Pakistan had agreed to provide concession. There has also been a delay in the agreed upon duty phase out (of 2007) on surgical gloves, soya meat, and chip board. There is an immediate desire that Pakistan should address all NTBs at the same time create a general awareness about this FTA.

Comparative Static Analysis
Results from Global CGE Model

The results from the global CGE model are exhibited in Table 6, where a static global general equilibrium framework is used to simulate the changes in macroeconomic variables under full trade liberalization between Pakistan and Sri Lanka. This in our simulation implies slashing the tariff rate by 95 percent. The results indicate that the real GDP increases for Pakistan by 0.054 percent however decreases for Sri Lanka by -0.001 percent. While the volume and value of imports and exports increase for both countries, the terms of trade deteriorate for Sri Lanka by 0.013 percent. Similarly household consumption for Pakistan increases by 0.058 percent but decreases for Sri Lanka by 0.011 percent. The investment levels in Pakistan and Sri Lanka increase by 0.012 and 0.036 percent respectively.

The overall incidence of macroeconomic results translates in to greater welfare and allocative efficiency gains for both countries (Table 7). The welfare (as measured by equivalent variation) increases for Pakistan ($10.8 million) and Sri Lanka ($8.6 million) but decreases for the rest of the world (that does not enjoy the preferences allowed under this FTA) by $4.7 million. The allocative efficiency not only increases for Pakistan ($2.6 million) and Sri Lanka ($8.74 million), but also for the rest of the world ($3.3 million). This scenario in general explains that full liberalization of trade between the two countries will lead to welfare and efficiency gains.

In a second simulation only partial liberalization is allowed i.e. cutting all tariffs by 50 percent. In this case the real GDP increases for both Pakistan (0.027 percent) and Sri Lanka (0.004 percent). Under this scenario the decline in household consumption for Sri Lanka is lesser (-0.001 percent) in comparison to the first simulation. The increase is investment for Sri Lanka is greater than Pakistan i.e. 0.02 percent compared to 0.006 percent (Table 8). As seen in the previous simulation, welfare and allocative efficiency increase for both countries. The rest of the world has a declining welfare, terms of trade and investment (Table 9).

Finally in Table 10 we see the impact of full trade liberalization between two countries on the sector-wise exports. The sectors in which Sri Lanka gains in terms of increased export value include: vegetables and fruits, grain crops, animal products, cattle, livestock, food, textile, wood, metal products, chemical, rubber, plastics, mineral and mineral products. The sectors in which Sri Lanka loses include: paper products, manufacturing, mining and extraction.

Pakistan although has some similarities to Sri Lankan portfolio of exports but the cost structures and underlying determinants of competitiveness certainly differ. The exporting sectors in which Pakistan gains include: heavy manufacturing, chemicals, rubber, plastics, textiles and clothing, wood, paper, food products, beverages, mining and extraction, animal products, grain crops, vegetables and fruits. The sectors in which Pakistan shows a loss include: cattle, livestock, processed food, metal products, and mineral products.

It is important to note that under our CGE simulations we have introduced across the board cuts in tariffs. This analysis has the limitation of not taking in to account the impact of negative lists which we try to address in the next section where we use a partial equilibrium model.

Trade Creation under PSFTA

Using the WITS – SMART model we calculate the partial equilibrium estimates for trade creation under PSFTA. An FTA is termed welfare enhancing if its net effect (i.e. after taking in to account any trade diversion) results in trade creation[19]. Table 11 shows the potential changes in country – specific exports (based on 2004 data i.e. pre – FTA data) due to concessions given by Pakistan to Sri Lanka. These gains are only in HS codes included in the concession list by Pakistan. The highest gains are seen for Canada followed by South Africa. In case of Sri Lanka there is an increase in exports of 8.8 percent. Countries that lose their exports include Bangladesh (-3.7 percent), Malaysia (-1.7 percent), and Vietnam (-1.1 percent) amongst others. Sri Lanka's exports in the HS codes allowed under the concessions list were 28.5 million before the FTA which potentially rise to 31 million after 100 percent phasing out envisaged in the agreement.

There is a 3.2 percent increase in the imports of Pakistan from Sri Lanka for items allowed in the concession list. There is however a 20 percent loss to the government in the form of tariff revenue which declines by $4.6 million. There is a positive incidence of lower tariffs and increased imports on the welfare as measured by consumer surplus which in turn rises by $0.6 million. The highest gains are seen for copra, meat preparations, organic surface – active agents, rubber thread, twine, fabrics (knitted or crocheted), lighting equipment, lamps and sealed beam units. The total trade effect indicates an average decline of -20.4 percent in

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[19] In case two low-cost producers of a tradable good enter in to a FTA, there will be no trade diversion effect. See Raihan (2008).

the overall weighted tariff rate by Pakistan on Sri Lankan goods. The concessions given by Pakistan under this FTA led to a trade creation effect amounting to $6 million (Table 13). Interested readers are welcome to request for the detailed country-specific and disaggregated commodity-wise results on trade diversion and creation.

The changes in exports as a result of concessions provided by Sri Lanka are calculated in Table **12**. Pakistan's exports under the allowed HS-codes increase by 24.3 percent. The countries that face a decline include: Australia, China, India, UAE, Turkey, USA and South Africa.

Sri Lankan imports under the specified HS codes increase by 0.7 percent and the loss of tariff revenue amounts to $0.6 million. Due to a very large negative list still in place from the Sri Lankan side the consumer surplus (welfare) as a result of FTA only amounts to $0.06 million. The highest gains are seen for oranges, juices, seeds, spices, mandarins, apples, chickpeas, and sanitary ware. The total trade effect as a result of Sri Lanka's decrease in tariffs amounts to $0.4 million with weighted tariff rate declining from 13.7 percent to 11.3 percent. The trade creation effect is much lower as compared to Pakistan's case. The combined trade creation effect of this FTA amounts to $6.4 million.

4. Conclusions

There has been an increase in bilateral trade between Sri Lanka and Pakistan in the post – FTA milieu. Today Pakistan is the second largest trading partner of Sri Lanka amongst South Asian economies. There have been some concerns about the negative trade balance for Sri Lanka however the lower prices have resulted in an increase in welfare for both countries. The negative trade balance for Sri Lanka can also be justified on the account that a significant proportion of Sri Lankan imports from Pakistan constitute raw material and related intermediate inputs that in turn lead to efficiency gains. Most noticeable are the over 30 percent imports from Pakistan, currently being used as raw material in Sri Lankan apparel sector. This industry making use of cheaper imports from Pakistan, in turn exports apparel to destinations that include US and EU.

Some concerns have also been raised from Pakistan side asking for a revision of export quotas of agriculture products from Pakistan. Currently Sri Lanka is importing apples, apricots, dates and other fruits at much higher prices from destinations such as US and Middle East.

Both countries have also been slow to find out markets for non-traditional exports even after the concessions provided under the FTA. This amongst other factors, points towards the productive capacity of developing countries who find it challenging to purse a policy of product diversification due to their own domestic structural constraints. Sri Lanka for example, continues to export primary commodities having marginal value added content in the

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post – FTA period. There is also an opportunity to regain lost markets. Sri Lankan tea is an example of how competitive advantages are lost over time. Around the signing of this FTA Sri Lanka's share in Pakistan's import of tea had fallen to around 3 percent compared to over 65 percent in early 1970s. However this will require efforts beyond the availing of concessions and moving pro-actively towards integrated supply chain systems.

Pakistan still has potential to fill in the demand in Sri Lanka particularly in sectors such as textile, leather, sports goods, surgical instruments, pharmaceuticals, iron, steel, kitchenware, and cutlery. There is a need to evaluate how Sri Lanka may be used as a lead destination to reach the potential Indian markets. Pakistani manufacturers may need to study the feasibility of having outlets in Sri Lanka in order to benefit from the regional preferential arrangements such as India – Sri Lanka bilateral FTA.

After the full implementation of this FTA and keeping in view the success achieved, both countries now need to move quickly towards a comprehensive economic partnership as there still exists further potential for cooperation in areas such as education, technology, tourism, and science. While Pakistan is at the cross-roads of key regional axis with close geographical proximity to Central Asian states, Sri Lanka enjoys duty free access in EU and India. While the trade balance is at this time in favour of Pakistan given the natural comparative advantages, Sri Lanka can gain further by promoting the FTA more at the national and local levels.

5. Making PK-SRI FTA Work: The Way Forward

The bilateral trade between Pakistan and Sri Lanka has experienced some gains in the post FTA period (as discussed in the previous sections) but still there is space left between the true potential of this FTA and its current utilization. Rationalization of tariffs in some cases might not just be enough for enhancing export performance, non-tariff barriers come in to play as a major trade impediment. Non-tariff barriers to trade have an important influence on reducing the benefits of increased market access and the export performance of businesses. Pre-FTA negotiations period serve as the building block for future gains perceived to come from the market access. A proper process of Pre-FTA evaluation, negotiations and awareness addressing key issues like potential gains, compliance costs etc is of utmost importance.

The main issues contributing to the low utilization of Pakistan-Sri Lanka FTA identified through this research study are as follows:

- Lack of awareness regarding the FTA
- Complex and time consuming procedure for obtaining the certificate of origin
- Domestic regulatory requirements in Sri Lanka are complicated
- Sri Lanka-India FTA has the possibility of trade diversion in case of Pakistan

- Lack of standard information and changes in rules and regulations
- Lack of coordination between Pakistan and Sri Lankan government and private sector trade bodies
- Container and packaging requirements in Pakistan are faced with rising costs and declining infrastructure
- Extensive filing of documentation and related paper work
- Low levels of checks and balance at Sri Lankan ports
- Customs facilitation to support the FTA in both countries is missing
- Lack of a structured FTA negotiating process

Following policy inputs are suggested for the removal of the above mentioned trade impediments:

Communication Strategy

In case of both Pakistan and Sri Lanka there has been no effort to establish a communication strategy for the FTA. The private sector largely remained un aware of the FTA which led to low levels of utilization. The communication channels utilized by MOC to promote the FTA remained narrow in nature. Awareness regarding the FTA was mainly generated through newspaper advertisement. Public seminars were not conducted. Officials at Trade and Development Authority of Pakistan (TDAP) reported that at the moment there is no standard communication strategy for any of the Pakistan FTA's. They further emphasized the fact that there was no communication plan carried out in the pre and post FTA period to take the stakeholders on board. The evidence of a stakeholder workshop carried out by TDAP is found after the FTA had been signed. The following areas are proposed for interventions:

- Increased effort on part of Sri Lankan and Pakistan government trade
   bodies in order to create awareness about FTA
- Promote coordination between trade associations and the government of Sri Lanka and Pakistan
- The role and mandate of TDAP needs to be clearly defined particularly as far as execution of initiatives relating to awareness and knowledge dissemination regarding the FTA's are concerned
- The consultative process with the private sector needs to be taken up with more rigour and in a structured manner
- A standard communication strategy needs to be developed in order to carry out the awareness plan for all the FTA's

Simplification of Trade Documents Procedure

The exporters/importers have to a large extent highlighted the issue of time required for filing of documentation and related paper work. The average time taken for each stage including: obtaining import/export codes, licences, processing of shipping bills, obtaining refunds, and customs clearances, is spread over weeks. The following areas need to be considered to resolve this issue:

• The burden of documentation needs to be lessened

• The process of obtaining the certificate of origin needs to be made facilitating

• The two governments need to cooperate in terms of developing such synergies which could integrate their custom processes and reduce the time spent in data clearance and supportive text materials required at the ports, airports, border crossing points and other official clearances

• Pakistan Government should initiate its trade related diplomatic efforts with Sri Lanka in order to ease the strictness observed regarding the acquiring of certificate of origin

Dispute Settlement Process

Several Pakistani exporters have reported financial loss due to non repayment of accounts receivables amid the liquidity crunch faced by foreign buyers. Many Sri Lankan importers place their orders with local bank guarantees which are difficult to obtain in Sri Lanka. Instances were also reported where due to low levels of checks and balances; substandard rubber was exported by Sri Lanka in violation of the consignment orders. Several occasions are reported where Sri Lankan importers have yet to honour the accounts payable since the past 6 months (after the delivery of consignment).

• Effort needs to be made in order to improve the dispute settlement mechanism for which both Governments are also required to increase coordination of their relevant trade organizations

• The arbitration process needs to be made more effective and less time consuming

• Trade offices aboard should play an instrumental role in registering protests with local trade bodies

Potential Traditional and non Traditional Sectors

After the full implementation of this FTA and keeping in view the success achieved, both countries now need to move quickly

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towards a comprehensive economic partnership as there still exists further potential for cooperation.

• Areas such as education, technology, tourism, and science need to be explored

• Pakistan still has potential to fill in the demand in Sri Lanka particularly in sectors such as textile, leather, sports goods, surgical instruments, pharmaceuticals, iron, steel, kitchenware, and cutlery

• There is a need to evaluate how Sri Lanka may be used as a lead destination to reach the potential Indian markets

• Removal of complementary goods from the negative list. For example in case of electrical imports while sockets are covered under FTA's immediate concession list, switches are not. Given that both these items are complimentary goods in many cases, there is ultimately very little decrease in preferences.

Trade Facilitating Measures

A free trade agreement needs to be supported with suitable trade facilitating measures without which business processes cannot be made easy. Major problems reported are in case of moving freight with in Pakistan, lack of special container and packaging requirements which in Pakistan are faced with rising costs and declining infrastructure, the Karachi port electronic care system was termed frustratingly slow, etc. The following suggestions are made in this regard:

• Rice stands exempted from customs care system, other perishable items in the food category should also be exempted with a view to improve the shipment time of consignment and avoid unnecessary delays

• There is also a need for improved customs facilitation, pre and post delivery checks at the port and at the same time facilitating better storage facilities at the port

• The state carrier Pakistan International Airlines (PIA) does not operate regular flights to Sri Lanka in all seasons which need to be increased in order to facilitate shipment by air

• The issues of medium to long term visas need to be addressed by the foreign office on both sides

• Government needs to take initiatives in improving the infrastructure related to special container required for perishable goods and packaging requirements

• Training of the customs staff in order to effectively implement the FTA

Rigorous Pre and Post FTA Negotiations process

The first step in the FTA process is a feasibility study which makes the fundamental framework for FTA negotiations which would enable the country to effectively present its case on the negotiating table. MOC documents suggest that the prime interest for signing an FTA with Sri Lanka comes from fear of losing Pakistani market in Sri Lanka to India after India and Sri Lanka signed an FTA in 2000. Generally, FTA's should drive its motivation from pure economic logic of integration. This was not probably the case with Pakistan.

Over all Pakistan Sri Lanka FTA remained a very simple FTA where most issues revolved around a few number of products. The important products for Pakistan were Rice and Potato while for Sri Lanka side it was Tea and Betel leaves. All these products came under the arrangement of tariff rate quota.

It appears from the document that there was no systematic effort by the MOC to consult industry representatives because once the FTA was signed, several industrial representatives contacted the ministry mainly expressing their concern over the possibility of Indian goods especially auto sector items entering in to Pakistan via Sri Lanka.

The above mentioned conclusion drawn from the analysis in section I depict lack of a rigorous FTA negotiations process. It is the absence of this process which has caused some structural problems in the FTA leading to low utilization. It is suggested that a proper FTA process framework should be adopted as discussed in section I in order to reap the benefits from Pakistan's future FTA's

Appendix

Table 1. *Pakistan's Imports from Sri Lanka (US$ Million)*

PRODUCT GROUP	Value 2003	Share (%)	Value 2004	Share (%)	Value 2005	Share (%)	Value 2006	Share (%)	Value 2007	Share (%)	Value 2008	Share (%)
Live animals; animals products	0	0.01%	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.01%
Vegetable products	24.38	63.84%	28.9	59.77%	25.51	56.97%	35.97	50.49%	35.47	56.02%	28.32	45.99%
Animal or vegetable fats and oils and their products; prepared edible fats; waxes.	0.48	1.27%	0.41	0.84%	0.41	0.91%	0.41	0.58%	0.33	0.53%	0.23	0.37%
Prepared foodstuffs; beverages, spirits and vinegar; tobacco and manufactured	0.02	0.06%	0.02	0.04%	0.02	0.04%	0.29	0.41%	0.11	0.17%	0.15	0.25%
Mineral products	0.25	0.66%	0.32	0.65%	0.28	0.63%	0.36	0.50%	0.47	0.74%	0.8	1.30%
Products of the chemical or allied industries.	0.84	2.20%	1.7	3.52%	1.25	2.80%	1.51	2.12%	0.76	1.19%	0.8	1.31%
Plastics and articles thereof; rubber and articles thereof	8.05	21.08%	12.8	26.55%	10.51	23.48%	19.15	26.88%	21.38	33.76%	24.86	40.38%
Raw hide and skins, leather, furskins; travel goods; Handbags; articles of animal guts	0	0.00%	0.04	0.08%	0	0.00%	0.06	0.08%	0.1	0.16%	0.22	0.36%
Wood and articles of wood; cork and articles of cork; manufactures of straw; basketware and wickerwork	0.38	1.00%	1.4	2.89%	2.66	5.94%	3.22	4.52%	2.17	3.43%	1.61	2.62%
Pulp of wood or of other fibrous cellulosic material; waste and scrap of paper; paper and paperboard	0.45	1.19%	0.5	1.03%	0.48	1.08%	0.42	0.59%	0.52	0.82%	0.45	0.72%
Textiles and textile articles	1.31	3.44%	0.99	2.05%	0.69	1.55%	1.38	1.93%	1.03	1.63%	2.87	4.67%
Footwear, headgear, umbrellas, sticks; prepared feathers and articles made therewith; artificial flowers; articles of human hair	0	0.00%	0.01	0.01%	0	0.00%	0	0.00%	0	0.00%	0	0.00%
Articles of stone, plaster, cement, asbestos, mica, ceramic, glass	0.02	0.06%	0.01	0.02%	0.01	0.03%	0.05	0.07%	0.1	0.15%	0.08	0.13%
Base metals and articles	1.02	2.67%	0.14	0.30%	0.22	0.50%	0.35	0.49%	0.26	0.41%	0.34	0.55%
Machinery and appliances; electrical equipment; sound recorders and reproducers, television image and sound recorders and reproducers, and parts and accessories	0.91	2.38%	0.48	0.99%	0.92	2.05%	0.5	0.71%	0.53	0.84%	0.55	0.89%
Vehicles, aircraft, vessels and transport equipment	0	0.00%	0.2	0.42%	1.74	3.89%	6.84	9.60%	0.01	0.02%	0.05	0.09%
Optical, photographic, cinematographer, measuring, checking, precision, medical or surgical instruments and apparatus; clocks and watches, musical instruments; parts and accessories	0.02	0.06%	0.36	0.74%	0.05	0.11%	0.06	0.08%	0	0.00%	0.01	0.01%
Miscellaneous manufactured articles	0.03	0.09%	0.05	0.10%	0.01	0.03%	0.65	0.91%	0.08	0.12%	0.23	0.37%

Table 2. *Pakistan's Exports to Sri Lanka (US $ Million)*

PRODUCT GROUP	Value 2003	Share (%)	Value 2004	Share (%)	Value 2005	Share (%)	Value 2006	Share (%)	Value 2007	Share (%)	Value 2008	Share (%)
Live animals; animals products	7.37	9.70%	6.03	6.16%	5.35	3.43%	5.44	3.42%	6.01	2.99%	6.03	2.81%
Vegetable products	13.65	17.97%	11.71	11.97%	30.77	19.73%	12.69	7.97%	22.9	11.42%	42.39	19.77%
Animal or vegetable fats and oils and their products; prepared edible fats; waxes.	0.01	0.01%	0	0.00%	0.01	0.00%	0	0.00%	0	0.00%	0.02	0.01%
Prepared foodstuffs; beverages, spirits and vinegar; tobacco and manufactured	1.16	1.52%	2.51	2.56%	1.62	1.04%	1	0.63%	2.26	1.12%	4.34	2.03%
Mineral products	0.16	0.22%	0.08	0.09%	0.05	0.04%	0.39	0.25%	1.37	0.68%	2.29	1.07%
Products of the chemical or allied industries.	5.79	7.62%	6.55	6.70%	8.06	5.17%	7.7	4.84%	9.26	4.62%	9.3	4.34%
Plastics and articles thereof; rubber and articles thereof	3.25	4.28%	4.13	4.23%	7.7	4.94%	6.8	4.27%	3.01	1.50%	3.08	1.44%
Raw hide and skins, leather, furskins; travel goods; Handbags; articles of animal guts	1.07	1.40%	0.68	0.69%	0.62	0.40%	1.07	0.67%	0.59	0.29%	1.31	0.61%
Wood and articles of wood; cork and articles of cork; manufactures of straw; basketware and wickerwork	0.01	0.02%	0.02	0.03%	0.52	0.33%	0.03	0.02%	0.03	0.02%	0.03	0.01%
Pulp of wood or of other fibrous cellulosic material; waste and scrap of paper; paper and paperboard	0.01	0.01%	0.03	0.03%	0.1	0.07%	0.07	0.04%	0.07	0.04%	1.75	0.82%
Textiles and textile articles	38.53	50.72%	60.23	61.60%	89.51	57.40%	111.28	69.92%	134.94	67.27%	127.52	59.47%
Footwear, headgear, umbrellas, sticks; prepared feathers and articles made therewith; artificial flowers; articles of human hair	0.28	0.36%	0.13	0.13%	0.54	0.35%	0.75	0.47%	0.47	0.23%	0.16	0.07%
Articles of stone, plaster, cement, asbestos, mica, ceramic, glass	0.16	0.21%	0.18	0.19%	0.17	0.11%	0.18	0.11%	1.07	0.53%	0.81	0.38%
Natural or cultured pearls, stones, metals, jewelry	0.05	0.07%	0.02	0.02%	0	0.00%	0.01	0.01%	0	0.00%	0	0.00%
Base metals and articles	2.1	2.76%	3.58	3.66%	7.25	4.65%	8.4	5.28%	11.47	5.72%	12.21	5.69%
Machinery and appliances; electrical equipment; sound recorders and reproducers, television image and sound recorders and reproducers, and parts and accessories	0.65	0.86%	0.57	0.58%	1.14	0.73%	0.59	0.37%	3.81	1.90%	2.08	0.97%
Vehicles, aircraft, vessels and transport equipment	1.04	1.37%	0.81	0.83%	1.59	1.02%	2.08	1.31%	2.66	1.32%	0.79	0.37%
Optical, photographic, cinematographer, measuring, checking, precision, medical or surgical instruments and apparatus; clocks and watches, musical instruments; parts and accessories	0.1	0.13%	0.15	0.15%	0.4	0.26%	0.29	0.18%	0.37	0.18%	0.11	0.05%
Arms & ammunition, parts & accessories	0.07	0.09%	0.01	0.01%	0.1	0.07%	0.01	0.01%	0	0.00%	0.06	0.03%
Miscellaneous manufactured articles	0.5	0.66%	0.36	0.37%	0.45	0.29%	0.37	0.23%	0.3	0.15%	0.18	0.09%

Table 3. *G-L Index of Intra-Industry Trade (2007)*

HS	Commodities	Sri Lanka	Pakistan
26	Ores slag & ash	0.128	0.978
08	Ed. Fruits & nuts, peel of citrus/melons	0.486	0.961
24	Tobacco & manuf. Tobacco substitutes	0.941	0.925
71	Pearls, stones, prec. Metals, imitation jewelry, coins	0.934	0.910
82	Tools, spoons & forks of base metal	0.308	0.910
56	Wadding, felt & nonwovens, special yarns, twine, cordage, ropes & cables & articles	0.607	0.895
65	Headgear & other parts	0.160	0.860
20	Preps of vegs, fruits, nuts, etc.	0.776	0.858
89	Ships, boats, & floating structures	0.282	0.857
55	Man-made staple fibers, inc. Yarns etc.	0.204	0.841
94	Furniture, bedding, cushions, lamps & lighting fittings nesoi, illuminated signs, nameplates & the like, prefabricated buildings	0.828	0.679
21	Misc. Edible preparations	0.853	0.525
68	Articles of stone, plaster, cement, asbestos, mica or similar materials	0.943	0.502
74	Copper & articles thereof	0.951	0.461
97	Works of art. Collectors' pieces, antiques	0.894	0.263
69	Ceramic products	0.881	0.206
23	Residues from food industries, animal feed	0.831	0.151
05	Products of animal origin	0.914	0.130

Table 4. *Pakistan: Improvement in TSI 2003 – 2007*

HS	Commodities	TSI 2003	TSI 2007
72	Iron and steel	-1.000	0.776
06	Live trees, plants, bulbs, roots, cut flowers etc	-1.000	-0.545
76	Aluminium and articles thereof	-1.000	-0.670
25	Salt, sulphur, earth, stone, plaster, lime and cement	-0.688	0.575
55	Manmade staple fibres	-0.552	0.957
90	Optical, photo, technical, medical, etc apparatus	-0.361	0.990
59	Impregnated, coated or laminated textile fabric	-0.333	0.980
28	Inorganic chemicals, precious metal compound, isotopes	0.368	1.000
70	Glass and glassware	0.375	0.998

Table 5. *Pakistan: Deterioration in TSI 2003 – 2007*

HS	Commodities	TSI 2003	TSI 2007
35	Albuminoids, modified starches, glues, enzymes	1	-0.962
19	Cereal, flour, starch, milk preparations and products	1	-0.337
57	Carpets and other textile floor coverings	1	-0.091
61	Articles of apparel, accessories, knit or crochet	1	0.895
63	Other made textile articles, sets, worn clothing etc	1	0.902
68	Stone, plaster, cement, asbestos, mica, etc articles	1	0.923
17	Sugars and sugar confectionery	1	0.984
95	Toys, games, sports requisites	1	0.986
20	Vegetable, fruit, nut, etc food preparations	1	0.994

Table 6. *Aggregate effects of Full Trade Liberalization between Pakistan and Sri Lanka (% Change)*

Variables	Pakistan	Sri Lanka
Real GDP	0.054	-0.001
Volume of imports	0.260	0.471
Volume of exports	2.194	0.678
Value of Exports	0.076	0.182
Value of Imports	0.062	0.213
Terms of trade	0.041	-0.013
Household consumption	0.058	-0.011
Investment	0.012	0.036
Government expenditure	0.032	-0.049

Table 7. *Welfare Decomposition under full trade liberalization (US $ Million)*

Region	Welfare	Allocative Efficiency	Terms of Trade	Investment
Pakistan	10.76	2.61	6.83	1.32
Sri Lanka	8.59	8.74	-0.97	0.82
Rest of the World	-4.7	3.3	-5.85	-2.14

Table 8. *Aggregate effects of Partial Trade Liberalization between Pakistan and Sri Lanka (% Change)*

Variables	Pakistan	Sri Lanka
Real GDP	0.027	0.004
Volume of imports	0.147	0.254
Volume of exports	1.16	0.392
Value of Exports	0.043	0.097
Value of Imports	0.034	0.113
Terms of trade	0.021	-0.004
Household consumption	0.03	-0.001
Investment	0.006	0.02
Government expenditure	0.16	-0.022

Table 9. *Welfare Decomposition under partial trade liberalization (US $ Million)*

Region	Welfare	Allocative Efficiency	Terms of Trade	Investment
Pakistan	5.63	1.44	3.51	0.68
Sri Lanka	4.72	4.62	-0.35	0.46
ROW	-2.6	1.69	-3.16	-1.13

Table 10. *Impact of full trade liberalization on exports from Sri Lanka and Pakistan (% change)*

Sectors	Sri Lanka	Pakistan
Vegetable and Frutis	0.939	73.336
Grains Crops	1.850	130.908
Animal Products	0.767	19.683
Cattle	1.245	-0.778
Livestock and Meat Products	0.933	-1.048
Mining and Extraction	-0.519	0.003
Beverages and Tobacco Products	0.149	69.542
Food Products	1.058	26.916
Processed Food	0.924	-0.274
Textiles and Clothing	88.626	3.231
Wood Products	124.261	3.301
Paper products	-0.188	50.463
Metal Products	116.219	-0.097
Light Manufacturing	-0.205	-0.057
Chemical, Rubber and Plastic	47.955	29.843
Mineral Products	100.650	-0.079
Heavy Manufacturing	-0.223	0.016
Utilities and Construction	-0.265	0.139
Transport and Communication	-0.256	0.076
Other Services	-0.220	0.049

Table 11. *Change in Exports as a Result of Concession List of Pakistan for Sri Lanka*

Exporter	Exports ($ '000)		($ '000)	Percentage
	Before	After	Change	Change
Bangladesh	126.55	121.81	-4.74	-3.7
Myanmar	1933.45	1912.69	-20.76	-1.1
Sri Lanka	28460.26	30966.96	2506.71	8.8
China	38239.02	38593.87	354.85	0.9
Malaysia	4694.58	4616.81	-77.77	-1.7
Vietnam	1063.44	1051.38	-12.06	-1.1
Others	111014	114259	3246	2.92

Table 12. *Change in Exports as a Result of Concession List of Sri Lanka for Pakistan*

Exporter	Exports	Exports	
	Before ($ '000)	After ($ '000)	Change
Australia	2321.45	2239.12	-82.32
China	8317.13	8275.03	-42.09
India	6145.88	6055.37	-90.51
Pakistan	3393.16	4218.20	825.04
Others	44622	44457	165

Table 13. *Potential Trade Effect as a Result of Concessions under PSFTA*

HS Code[20]	Trade Total Effect	Trade Diversion Effect	Trade Creation Effect	Old Duty Rate	New Duty Rate
	($ '000)			(%)	
Result of concessions by Pakistan	5,991.8	0.0	5,991.8	19.3	16.6
Result of concessions by Sri Lanka	444.763	0.0	444.763	13.83	12.84

[20] Potential effects calculated on 2004 data from COMTRADE.

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Over the past decade Pakistan remained involved in two major trade agreements with in the South Asia (Pakistan & Sri-Lanka FTA and SAFTA). It is meaningful from an operational and policy perspective to evaluate Pakistan's trade performance in South Asia against its objectives of greater trade integration and suggest policy interventions to improve its effectiveness. In order to achieve this objective, current study evaluates the Pakistan's overall and chapter-wise trade performance with SAARC major SAARC economies for the last seven years (2003-09). This study has been disaggregated into two parts: In the first part of the study, an assessment of trade performance of SAARC members is carried out with respect to the rest of the world. Pakistan's trade performance vis-à-vis other SAARC members is the focus of this part. In the second part Pakistan's trade performance in South Asia has been analyzed and policy interventions have been suggested to improve its effectiveness. Certain trade indicators like Trade Complementarity Index (TCI), Trade Specialization Index (TSI), Grubel Lloyd Index (GLI), Revealed Comparative Analysis (RCA), Bilateral Revealed Comparative Analysis BRCAs and Revealed Market Access (RMA) have been employed to achieve the above objectives.

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