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AGRICULTURAL TRADE POLICY OPTIONS FOR SRI LANKA DURING CRISIS TIMES

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The past three years were an eventful era for Sri Lanka whose economy had previously been relatively open and highly trade dependent. The era started with rapidly rising food and commodity prices and ended with a global financial crisis and a worldwide recession. These events coincided with a number of major changes in the domestic economy – a political push to increase local agricultural production and the end of 30 years of civil conflict. These developments led to a greater sense of nationalism among the general public and rising protectionism was one of the outcomes. At the same time, the agricultural sector started to grow more rapidly as a result of changes in global food market conditions (higher prices), more resources being devoted to agricultural production and the protectionist policies.

> The current dilemma facing policy makers is the approach that should be followed to achieve Sri Lanka's development objectives. Should the protectionist policies implemented during the crisis era be continued? What are the other policy options, and what are the advantages of trade led growth?
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> Although it is tempting to maintain a protectionist policy regime, the findings from economic research support the use of a trade led growth strategy. The following are the key findings from this literature.

(a) Historically, Sri Lanka achieved higher economic growth during periods times when the economy was more open. Research indicates that certain agricultural sectors in Sri Lanka, such as paddy rice grown under rain fed conditions and other field crops, are not competitive on world markets under "normal" market conditions. Although the recent food price hike was unprecedented there are clear signs of a return to lower price levels. Therefore, it is unlikely that the advantageous market conditions agricultural producers have enjoyed in the recent past will prevail into the future.

(b) Sri Lanka has achieved few rewards from regional economic integration and the multilateral World Trade Organization negotiations remain moribund.

   a. In its South Asian regional trade agreements most agricultural products have been largely taken off the table by Sri Lanka (included in the negative list of sensitive products not subject to liberalization). Sri Lanka has been more protectionist than most countries in the region putting 558 items on its negative list under the India-Sri Lanka Free Trade Agreement (ISFTA), whereas India has specified only 19 items as of September 2008 as per the official texts. In the Pakistan Sri Lanka Free Trade Agreement (PSFTA), Sri Lanka has put 206 products on its negative list whereas Pakistan has specified only 70 items as of September 2008. This protectionist approach towards both India and Pakistan, two of Sri Lanka's major trading partners effects what it is able to achieve in these negotiations - negotiations where there are opportunities yet to be captured through enhanced trade.

b. The margin of preference given to Sri Lanka for its agricultural sector in South Asian trade agreements is small. The preference margin in the ISFTA is larger than in the PSFTA and SAPTA but they are still modest.

c. There is room to acquire larger gains from trade through regional economic integration if both the manufacturing and the agricultural sectors are liberalized as is evident from policy simulations conducted using global trade models. Unilateral liberalization by South Asia is another strategy that could be used to enhance economic growth but it is politically difficult everywhere.

d. India is the dominant and most crucial trading partner of Sri Lanka (even when other economic and physical factors affecting food and beverage trade flows are controlled for) as evident from gravity models of trade flows.

e. The downside to further market integration, for Sri Lanka, are difficult to predict and uncertain losses occur when a major trading partner such as India impose trade restrictions. Economic analysis shows that while India's implementation of trade restrictions, through export taxes, may improve India's welfare these policies harm other countries in South Asia including Sri Lanka. While the primary objective of these restrictive policies is to lower domestic prices in the country imposing them, the consequent reductions in the country's output and export levels causes world prices to rise even higher – a classic beggar-thy-neighbor policy. Constraining these policies becomes doubly difficult when the large country imposing them might reap welfare gains through the effects of the taxes on their terms of trade.

The above arguments suggest that Sri Lanka's long term interests in economic growth are unlikely to benefit from protectionist policies. Carefully orchestrated more liberal trade policies achieved multilaterally and through meaningful regional economic integration should be Sri Lanka's focus in the future.