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Sri Lanka-China FTA: Challenges and Opportunities

Insights from Analysing China's
Existing FTAs

ECONOMICS

April
2018

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1. INTRODUCTION

Sri Lanka and China decided to enter into a Free Trade Agreement (FTA) in August 2013 to further expand trade between the two countries.¹ Technical negotiations, which officially commenced in September 2014, are still underway with five rounds of negotiations having been concluded.² The negotiations are expected to conclude sometime in 2018.³

China is the world's second largest economy, largest exporter and second largest importer. For a small market economy like Sri Lanka, an agreement with a country like China presents exciting opportunities as well as daunting challenges.

The aim of this briefing note is to assess the challenges and opportunities that Sri Lanka is likely to face in operating under an FTA with China. Potential challenges and opportunities have been identified by analysing the key features of China's existing FTAs with other countries. The analysis will focus mainly on the provisions that govern trade in goods. The first section of the note will deal with the potential challenges associated with an FTA with China, while the second section will examine the opportunities.

2. KEY FINDINGS

2.1. Potential challenges:

- Sectoral coverage of the Sri Lanka-China FTA is likely to be more comprehensive than the coverage in Sri Lanka's previous FTAs, and provisions are likely to go beyond trade in goods [For more information, refer Section 3.1.].
- The liberalisation commitments in the Sri Lanka-China FTA are likely to be more ambitious than those in Sri Lanka's previous FTAs: both the product coverage and the range of products on the immediate concession list (i.e. the list of products for which

¹ Ministry of Foreign Affairs Sri Lanka. 'Joint Feasibility Study on the Sri Lanka – China Free Trade Agreement finalized', 21 March 2014, available at: <http://www.mfa.gov.lk/index.php/en/categoryblog/4505-joint-feasibility-study-on-the-sri-lanka-china-free-trade-agreement-finalized>, [accessed on: February 2018].

² The time taken to conclude an agreement with China has been highly country specific, having varied between two years (with Pakistan) to ten years (with Australia). The time and effort taken to complete these FTAs have been affected by a host of factors including the perceived costs and benefits of the agreement, the extent of public resistance and support, and the political influence each government has over their citizens and over the partner country.

³ Azhar Razak, 'FTA with Singapore in the pipeline', 24 December 2017, available at: <http://www.sundayobserver.lk/2017/12/24/business/fta-singapore-pipeline>, [accessed on: February 2018].

tariffs are reduced to zero on the day the agreement comes into effect) are expected to be high [For more information, refer Section 3.2.].

- China's FTAs have provisions that restrict the use of safeguards to protect domestic industries, namely non-tariff measures (NTMs) and para-tariffs (which Sri Lanka has used extensively) [For more information, refer Section 3.3.].

2.2. Opportunities

- Leading export products of Sri Lanka presently face relatively high tariffs when entering the Chinese market. If tariffs are a significant barrier to entry faced by Sri Lankan exporters at present, then a FTA that leads to a reduction of tariffs, will help improve Sri Lankan exporters' access to the Chinese market [For more information, refer Section 4.1.].
- As tariffs are not a major barrier faced by leading Chinese imports entering Sri Lanka (as a significant portion of these products already enter the country free of duty), reduction of tariffs under the FTA is likely to yield higher gains for Sri Lanka than for China. (This analysis is based purely on tariffs and has not taken into consideration the impact of para-tariffs or NTMs and the supply side constraints faced by Sri Lankan exporters) [For more information, refer Section 4.2.].
- Although China has typically treated its developing country partners as equals regardless of size (i.e. it has typically applied terms and conditions on both parties equally), there is opportunity to negotiate a longer tariff phase-out period to allow sufficient time for domestic industries to adjust for import competition [For more information, refer Section 3.2.].

3. POTENTIAL CHALLENGES

This section considers the potential challenges Sri Lanka is likely to face when entering into a FTA with China, in relation to the scope of the agreement and the provisions governing trade in goods.

3.1. China's FTAs are more comprehensive than Sri Lanka's in terms of the sectors covered

China's FTAs, go beyond trade in goods and include trade in services and investment, as well as other trade-related subjects such as intellectual property rights, the environment, government procurement and trade facilitation. Even in its narrowest FTAs – signed with Chile and Pakistan, which were also amongst its first bilateral FTAs – both trade in goods and trade in services were covered. The only difference with these two agreements is that the trade in services was included three years after signing of the agreement on trade in

goods. In all other subsequent agreements, the negotiations on trade in both goods and services were concluded at the same time. Although all of China's FTAs cover more than just trade in goods, the number of sectors covered varies by country (see Exhibit A1).

In contrast, only one of Sri Lanka's FTAs covers more than trade in goods: the Sri Lanka-Singapore FTA, which was signed on 23 January 2018. Sri Lanka's other two bilateral agreements – with India (1998) and Pakistan (2006) – cover only trade in goods. Although Sri Lanka, in 2005, attempted to expand the sectoral coverage of its FTA with India to include services and investment,⁴ the agreement faced stiff opposition from domestic industries and professionals, missed several deadlines and is still under negotiation. Additionally, Sri Lanka entered into a framework agreement on services with countries in the South Asian Association for Regional Cooperation (SAARC) in 2010. However, to this date, the respective countries have failed to table the liberalisation commitments on services under the agreement.

This analysis indicates that an agreement between China and Sri Lanka is likely to cover more than trade in goods. This prediction is supported by information on trade negotiations published on the website of China's Ministry of Commerce. The website states that negotiations between the two countries have, to date, covered trade in goods, trade in services, and investments.⁵

3.2. China's FTAs reduce tariffs on a higher range of products compared to Sri Lanka's FTAs

The market access provided by both parties in China's FTAs with developing countries is greater than the access provided in Sri Lanka's current agreements. For example, in the bilateral FTAs China has signed with developing countries (excluding Pakistan), China and the partner country have agreed to reduce tariffs for over 90% of tariff lines and 90% of the traded products. Even in the agreement with Pakistan, the product coverage is as high as 85%, with an agreement to increase this figure to 90% at a mutually agreed date (see Exhibit 1). In contrast, Sri Lanka has not agreed to reduce tariffs to this extent in any of its current agreements, including its most recent agreement with Singapore. Sri Lanka has reduced tariffs for around 78% of products from India⁶, 88% of products from Pakistan⁷ and agreed to reduce up to 80% of products from Singapore.⁸

⁴ Daily Mirror, 'SAARC Agreement on Trade in Services: Tardy Progress', 24 November 2014, available at: <http://www.dailymirror.lk/57189/saarc-agreement-on-trade-in-services-tardy-progress>, [accessed on: February 2018].

⁵ Ministry of Commerce, PRC, 'The 5th Round of China-Sri Lanka FTA Negotiation Held' 20 January 2017, available at: http://fta.mofcom.gov.cn/enarticle/ensri/enchinasrinews/201702/34198_1.html, [accessed on: February 2018].

⁶ Department of Commerce, Indo – Sri Lanka Free Trade Agreement (ISFTA), available at: http://www.doc.gov.lk/index.php?option=com_content&view=article&id=43&Itemid=154&lang=en, [accessed on: February 2018].

⁷ Department of Commerce, Pakistan – Sri Lanka Free Trade Agreement (PSFTA), available at: http://www.doc.gov.lk/index.php?option=com_content&view=article&id=30&Itemid=155&lang=en, [accessed on: February 2018].

⁸ Lianne Chia. 'Singapore and Sri Lanka sign free trade agreement', Channel News Asia, 23 January 2018, available at: <https://www.channelnewsasia.com/news/singapore/singapore-and-sri-lanka-sign-free-trade-agreement-9886990>, [accessed on: February 2018].

Additionally, China and its developing partner countries have reduced tariffs on 60-70% of products at the commencement of their FTAs, with the remainder reduced over an agreed period.⁹ In comparison, Sri Lanka has agreed to reduce tariffs on a far smaller percentage of products from the commencement of its FTAs: in its agreements with Pakistan and India, Sri Lanka liberalised tariffs immediately for less than 10% of products (at HS 6-digit level – 102 products with Pakistan and 319 products with India).¹⁰ In the recently concluded FTA with Singapore, Sri Lanka has agreed to liberalise import duty on 50% of tariff lines.¹¹ If the tariff phase-out only covers import duty (and excludes para-tariffs like import cess, PAL), committing to immediate liberalisation of 50% of the tariff lines is not difficult for Sri Lanka. This is because the country already allows products falling within 55% of tariff lines to enter Sri Lanka duty free, from anywhere in the world.

Further, in its FTAs with developing countries, China has not extended special concessions – such as allowing the partner country to have a lower product coverage, or a longer tariff phase-out period (see Exhibit 1). In such agreements, the product coverage and the years taken to liberalise tariffs has been the same for both countries. Even small developing economies like Costa Rica have been treated as an equal partner by China.

In contrast, Sri Lanka has been able to secure longer tariff phase-out periods and lower product coverage in its current agreements with India and Pakistan. In the India-Sri Lanka FTA, Sri Lanka took eight years to bring down tariffs while India took only five years. In the Pakistan-Sri Lanka FTA, Sri Lanka took five years to bring down tariffs, while Pakistan took three years.

China's FTAs however, indicate that China has been generous in providing longer time to phase-out tariffs for some countries (see Exhibit 1). The shortest tariff phase-out period agreed by China to date is 5 years (with Pakistan) and the longest, 17 years (with Peru). The shortest time taken to phase-out tariffs in Sri Lanka's FTAs is 5 years (also with Pakistan) and the longest, 15 years (with Singapore in the recently signed FTA).¹² This indicates that despite the extensive coverage of products and trade, there is provision to address some of the concerns of the domestic industries by negotiating a longer tariff phase-out period. Current media discussions on the Sri Lanka-China FTA indicates that China has agreed to a 20-year tariff phase-out period.¹³ If that is the case, it will be the longest tariff phase out-period China has agreed to with a FTA partner.

⁹ In FTAs with the more developed economies, however, China has opted to liberalise only up to 20-30 percent of products immediately and the balance over a period. The developed partner countries have agreed to bring down tariffs over 90 percent of products immediately.

¹⁰ Saman Kelegama and Chandana Karunaratne (IPS), 'Experiences of Sri Lanka in the Sri Lanka – India FTA and the Sri Lanka – Pakistan FTA', January 2013, available at: http://unctad.org/en/PublicationsLibrary/ecidc2013misc1_bp10.pdf, [accessed on: February 2018].

¹¹ Jayani Ratnayake, Presentation on Singapore – Sri Lanka FTA. Seminar on Singapore – Sri Lanka FTA, 16 February, 2018, Ceylon Chamber of Commerce.

¹² Lianne Chia. 'Singapore and Sri Lanka sign free trade agreement', Channel News Asia, 23 January 2018, available at: <https://www.channelnewsasia.com/news/singapore/singapore-and-sri-lanka-sign-free-trade-agreement-9886990>, [accessed on: February 2018].

¹³ Bandula Sirimanna, 'China-Lanka tariff plan needs extreme caution: Local industry', 19 February 2017, available at: <http://www.sundaytimes.lk/170219/business-times/china-lanka-tariff-plan-needs-extreme-caution-local-industry-229309.html>, [accessed on: February 2018].

**Exhibit 1: Tariff Liberalisation commitments of selected China FTAs
(concessions extended to imports from the partner country)**

Partner Country	Product Coverage ¹⁴ (HS 8 digit)		Trade Coverage ¹⁵ (% of exports)		No Concession Lists (% of tariff lines)		Tariff phase out period (years)	
	China	Partner	China	Partner	China	Partner	China	Partner
Australia	96.7%	100.0%	97.0%	100.0%	3.3%	0%	15	5
New Zealand	97.2%	100.0%	96.0%	100.0%	2.8%	0%	12	9
Switzerland	94.3%	96.8%	96.5% ¹	99.7%	5.7%	3.2%	10 to 15	Immediate
Chile	97.2%	98.1%	-	-	2.8%	1.9%	5 to 10	5 to 10
Costa Rica	96.7%	91.1%	Over 90%	Over 90%	3.3%	8.9%	15	15
Pakistan ²	85.0%	83.6%	-	-	15%	15% Excluded – 1.4% ³	5	5
Peru	94.6%	91.95%	99.0%	90.0%	5.4%	8.05%	17	17

¹ Although 96.5% of the value of Swiss Exports to China receive concessions, only 84.2% of the value of Swiss Exports would receive zero tariffs, 12.3% of the exports are subject to reduced tariffs.
² Pakistan and China agreed to increase product coverage up to 90% through friendly consultations on an agreed timeline.
³ The 1.4% in the excluded list are different from the no concession list as these goods are banned goods which are not permitted to be imported into Pakistan from China.

Source: Ministry of Commerce, PRC, China FTA Network.

3.3. Limited possibility of safeguards in the form of NTBs and para-tariffs

China is the world's largest exporter, accounting for 13% of world exports – valued at USD 2,098 billion in 2016.¹⁶ China's exports have doubled during the last decade. In this context, the comprehensive product coverage and ambitious tariff liberalisation schedule in China's FTAs are seen as threats by domestic industries, as they must compete with Chinese imports which are highly price competitive.¹⁷ Further, FTAs of China limit the ability of a country to use non-tariff barriers (NTBs) and para-tariffs (which Sri Lanka uses extensively) to protect domestic industries from import competition.

¹⁴ Refers to number of tariff lines covered as per the HS classification of products at 8-digit level.

¹⁵ Refers to the coverage of products traded between the two countries.

¹⁶ International Trade Centre, Trade Map (2016), available at: <http://www.trademap.org>, [accessed on: February 2018].

¹⁷ Bandula Sirimanna, 'China-Lanka tariff plan needs extreme caution: Local industry', 19 February 2017, available at: <http://www.sundaytimes.lk/170219/business-times/china-lanka-tariff-plan-needs-extreme-caution-local-industry-229309.html>, [accessed on: February 2018].

China's FTA restricts the use of para-tariffs

Sri Lanka has frequently used a para-tariff known as Import Cess to provide protection to domestic industries. Para-tariffs refer to taxes that are applicable only on imports and that are imposed on top of customs duty.

While the India-Sri Lanka FTA contains no provisions preventing Sri Lanka from using para-tariffs, the Pakistan-Sri Lanka FTA specifically states that such para-tariffs should not be applied over products liberalised under the FTA. Sri Lanka has continued to use para-tariffs on imports from both of these countries, which in the case of Pakistan contravenes the relevant provisions in the FTA. According to Sri Lanka's 2015 tariff schedule, Import Cess was imposed on 941 products that were given duty free access under the India-Sri Lanka FTA and 1,292 products that were given duty free access under the Pakistan-Sri Lanka FTA.

China's FTAs restricts the use of para-tariffs, such as the Import Cess used by Sri Lanka, which function as indirect measures of protection for domestic goods or taxes such as the Port and Airport Development Levy (PAL) levied only on imports for fiscal purposes¹⁸ (see Exhibit 2).

Over the years, Import Cess and PAL, which are applied over and above Customs Duty on a significant portion of products imported into Sri Lanka, have provided a very high level of protection to domestic producers of these products. Given the unilateral liberalisation measures proposed by the Government of Sri Lanka, and pressure from FTA partners, the room to use para-tariffs as a means of providing protection is likely to decline in the future. According to information that is publicly available, China has already requested that Sri Lanka phase-out import cess over a period of five years.¹⁹ Further, Sri Lanka has already agreed to eliminate Cess and PAL in 5 equal instalments between the 6th to 10th year in the recently concluded FTA with Singapore.²⁰

China's FTAs restrict the use of non-tariff barriers

NTBs refer to non-tariff measures such as regulatory and procedural requirements (e.g. permits, licenses, standards) that act as hindrances to international trade. It is common to find that countries particularly resort to these types of measures to discourage imports when tariff protection decreases.

Although Sri Lanka has not made extensive use of NTBs to protect its domestic industry, some of its FTA partners, such as India, have been criticised for their extensive use of NTBs to discourage imports from Sri Lanka.²¹ An area of weakness in Sri Lanka's current

¹⁸ Article 9, paragraph 1 -Administrative fees and formalities, China Pakistan Free Trade Agreement, available at: http://fta.mofcom.gov.cn/pakistan/xieyi/fta_xieyi_en.pdf, [accessed on: February 2018].

¹⁹ Daily Mirror, 'China-Sri Lanka FTA: Industrialists caution of adverse impacts on domestic industry', 7 March 2017, available at: <http://www.dailymirror.lk/article/China-Sri-Lanka-FTA-Industrialists-caution-of-adverse-impacts-on-domestic-industry--125004.html>, [accessed on: February 2018].

²⁰ Jayani Ratnayake, Presentation on Singapore – Sri Lanka FTA. Seminar on Singapore – Sri Lanka FTA, 16 February 2018, Ceylon Chamber of Commerce.

²¹ Daily Mirror, 'Exports to India: Putting the "free" back into the free trade agreement', 22 July 2017, available at: <http://www.dailymirror.lk/80501/exports-to-india-putting-the-free-back-into-the-free-trade-agree>, [accessed on: February 2018].

bilateral FTAs is the absence of provisions limiting the use of NTBs to undermine the benefits of tariff concessions to the exporter.²²

In contrast, of China's seven selected FTAs, four make explicit reference to non-tariff measures (see Exhibit 2 for further details of these agreements).²³ For example, paragraph 2 of Article 8 of the China–Singapore FTA states:

Neither Party shall adopt or maintain any non-tariff measure on the importation of any good of the other Party or on the exportation of any good destined for the territory of the other Party, except in accordance with its WTO rights and obligations, or in accordance with other provisions of this Agreement.

Exhibit 2: Provisions to restrict the use of Para-Tariffs and Non-Tariff Barriers in selected FTAs of China

Agreement	Restrictions on use of Para-Tariffs (i.e. taxes applicable only on imports over and above customs duty)*	Provisions on NTB		
		Explicit mention of the elimination of NTB in the agreement unless otherwise stated	Technical Barriers to Trade (TBT)	Sanitary and Phytosanitary measures (SPS)
China - Australia	✓	✓	✓	✓
China - New Zealand	✓	✓	✓	✓
China - Switzerland	✓	✗**	✓	✓
China - Chile	✓	✗**	✓	✓
China - Costa Rica	✓	✓	✓	✓
China - Pakistan	✓	✗**	✓	✓
China - Peru	✓	✓	✓	✓

* These restrictions are in accordance with Article III:2 of the General Agreement on Trade and Tariff (GATT), which states that imports 'shall not be subject, directly or indirectly to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1'. The key principle referred to in paragraph 1 is 'not applying in a manner to afford protection to domestic production'.

** These agreements do not explicitly mention the term 'NTBs'. However, they refer to the elimination of quantitative restrictions (Switzerland) and agree that quantitative restrictions such as tariff rate quotas are not a permissible form of safeguard measure.

Source: Ministry of Commerce, PRC, China FTA Network.

Additionally, each of China's agreements has separate provisions limiting the use of technical standards, and sanitary and phytosanitary measures (i.e. measures in place to protect human, animal and plant life and health) to intentionally discourage imports. In

²² As the time, this report was written, the text of the agreement between Singapore and Sri Lanka is not available to assess how the FTA has tackled the issue of NTMs, as well as technical barriers and phytosanitary measures.

²³ The seven FTAs selected for this analysis are China's FTAs with Australia, New Zealand, Switzerland, Chile, Costa-Rica, Pakistan and Peru.

contrast, Sri Lanka's existing bilateral agreements with India and Pakistan do not contain any provisions on technical barriers or sanitary and phytosanitary measures.

From the provisions present in China's other FTAs, it appears likely that the Sri Lanka-China FTA will contain provisions that restrict the use of both non-tariff barriers and para-tariffs to protect domestic industry.

4. OPPORTUNITIES FOR SRI LANKA IN THE CHINA FTA

While the FTA may pose some challenges, as outlined in the section above, it is also likely to contain some opportunities that can benefit Sri Lanka in its trade with China.

4.1. Potential for Sri Lanka to grow exports

As the second largest importer in the world, China accounted for 10% of the world's imports in 2016, valued at USD 1,588 billion.²⁴ Additionally, the value of imports into China has nearly doubled over the last decade. However, China still maintains relatively high import tariffs. Of the world's top 10 importers, who accounted for 53% of world imports in 2016, China is the only country that has maintained an average import tariff of over 10% (10.9% to be exact). Other than South Korea, which maintains an average tariff of 7.3%, the average import tariff rate for the remaining eight leading importers is below 3%.²⁵

Increasingly, countries are entering into FTAs with China to improve access to its large and fast-growing market by reducing barriers to trade. At present, 23 countries including Hong Kong, Macau and the 10 ASEAN member countries²⁶ have already gained preferential access to the Chinese market through FTAs. Exports from these countries accounted for 33% of China's total imports in 2016. Several other countries are in the process of negotiating market access through FTAs (see Exhibit A2). The key objective of the proposed Sri Lanka-China FTA is also to enhance exports to the Chinese market. To do so, it is important to give greater emphasis to trade coverage and the removal of tariffs on key exportable products.

Emphasis on trade coverage rather than product coverage

For a country like Sri Lanka, which has a limited number of exportable products, the benefits of an FTA with China will largely depend on the ability of the negotiators to reduce barriers with respect to key exportable products. According to the trade database of the International Trade Centre, over 5,600 products classified by the World Customs

²⁴ International Trade Centre, Trade Map (2016), available at: <http://www.trademap.org>, [accessed on: February 2018].

²⁵ *Ibid.*

²⁶ Association of South East Asian Nations (ASEAN) member countries are Myanmar, Thailand, Malaysia, Singapore, Brunei, Indonesia, Laos, Cambodia, Vietnam and the Philippines.

Organisation (WCO) at HS 6-digit level are traded across the world.²⁷ Sri Lanka's exports to the world consists of only half of these products (2,887 products). The number of products Sri Lanka exports to China is even smaller (451 products) (see Exhibit 3 for more information).

Exhibit 3: No of products traded by China and Sri Lanka at HS 6-digit

China Exports		Sri Lanka Exports	
	No of Products at HS 6 digit		No of Products at HS 6 digit
To Sri Lanka	2950	To China	451
To the World	4855	To the World	2887

Source: Trade Map – International Trade Center (ITC)

Similarly, a limited number of products contribute to Sri Lanka's export revenue. Out of Sri Lanka's total exports to the world, just 100 products accounted for 80.5% of the country's total export revenue in 2016.²⁸ In the same year, Sri Lanka exported 79 of these products to China (see Exhibit 5).

Thus, for a country like Sri Lanka, whose exports are confined to a few products, an agreement that reduces barriers to trade on thousands of other products but excludes these key exportable products to the world and to China will fail to facilitate Sri Lanka's export growth.

Reduction of high import duty on key exportable products

Despite a six-fold increase in exports from Sri Lanka to China in the last decade, Sri Lankan exports to China account for a mere 2% of total exports, or USD 211 million in value terms (see Exhibit 4). The value and share of Sri Lankan exports to China remains low compared to those of Sri Lanka's South East Asian neighbours. For example, in 2016, China accounted for 17% of total exports from Vietnam (USD 37 billion), 13% of total exports from Malaysia (USD 24 billion), and 11% of total exports from Thailand (USD 24 billion).²⁹ These countries enjoy duty concessions in the Chinese market through the China-ASEAN FTA concluded in 2005.

Sri Lanka and China are already members of a preferential trade agreement known as the Asia Pacific Trade Agreement (APTA).³⁰ Under APTA, Sri Lanka can export 2,191 products

²⁷ Harmonised System of Classification (HS) – The Harmonised system of classification was developed by the World Customs Organization to assess the product concentration and composition of exports. The level of detail in the classification of the products depends on the HS level specified. For example, a product classified at 4-digit level is more specific than product classified at 2-digit level. For example, dairy products are be classified at 2-digit level at HS 04, while Concentrated Milk in particular is be classified as 0402 at 4-digit level.

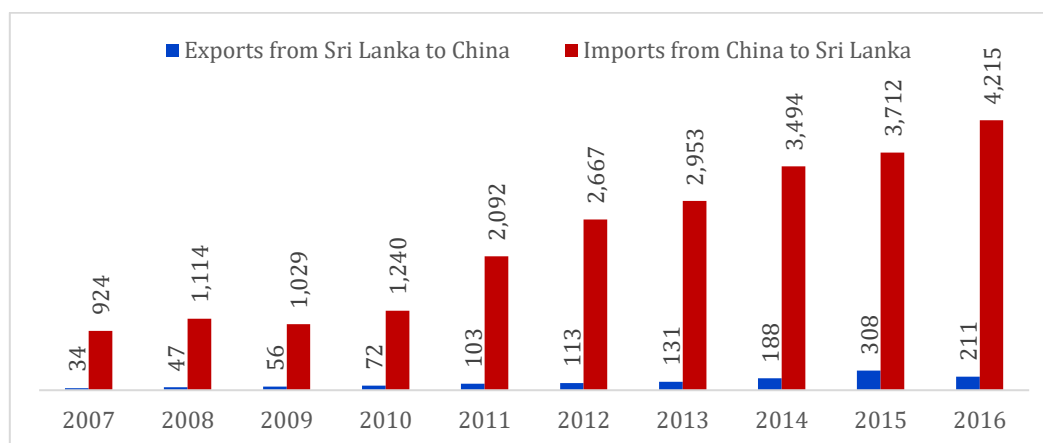
²⁸ International Trade Center, Trade Map, 2016, available at: <http://www.trademap.org>, [accessed on: February 2018].

²⁹ *Ibid.*

³⁰ Other member countries of APTA are Bangladesh, India, Laos and South Korea. APTA (previously the 'Bangkok Agreement') has been in place since 1975. China became a member of APTA in 2001.

to China (classified at HS 8 digits) at concessional duty rates.³¹ In 2016, 44% of exports to China (i.e. USD 92 million) entered the Chinese market at concessional duties offered by APTA.³²

Exhibit 4: Trade between Sri Lanka and China, (USD Mn)



Source: Central Bank of Sri Lanka, Annual Report 2011 and 2016

Exhibit 5: Top 100 products exported from Sri Lanka to the World

	Tariffs applied by China					
	0-5%	>5-10%	>10-15%	>15-20%	Over 20%	Total
Exports to the World						
No of products (HS 6 digit)	19	27	38	12	4	100
Value (USD Mn)	915	3015	3521	888	154	8493
Value as a % of total exports of Sri Lanka to the world	8.7%	28.6%	33.4%	8.4%	1.5%	80.6%
Exports to China						
No of products (HS 6 Digit)	10	21	36	10	2	79
Value (USD Mn)	26	61	58	15	0.4	160.4
Value as a % of total exports of Sri Lanka to China	12.3%	28.9%	27.5%	7.1%	0.2%	76%

Source: Calculated using data published in the International Trade Center (ITC), Trade Map and the World Integrated Trade Solutions (WITS) – World Bank, TRAINS database.

Even after factoring in the concessions already available under APTA, 54 products out of the 100 leading exports of Sri Lanka (at HS 6 digit; and which account for 80% of Sri Lanka's total exports) face tariffs of over 10% when entering China (see Exhibit 5). These

³¹ United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP), 'Trade, Investment & Innovation', APTA, available at: <http://www.unescap.org/apta>, [accessed on: February 2018].

³² Department of Commerce of Sri Lanka, 'International Trade, Statistics of Sri Lanka – 2016', available at: http://www.doc.gov.lk/images/pdf/downloads/statistic/international_trade_statistics_of_sri_lanka_2016.pdf, [accessed on: February 2018].

54 products consist of apparel, rubber products, tea, coconut-based products, gems, fish products, electrical parts etc., (a list of the top 20 products out of these 54 products is provided in Exhibit A3). If tariffs are presently the key barrier that constrain exports to China, a FTA with reduced tariffs, for these products will help improve access to the Chinese market.

4.2. Potential impact on Sri Lanka's imports

China is the largest source of imports into Sri Lanka and accounted for 22% of Sri Lanka's imports in 2016.³³ Imports from China to Sri Lanka have increased five-fold over the last decade (Exhibit 4). Sri Lanka imports nearly 3,000 different products from China (at HS 6 digit). The top 100 products imported to Sri Lanka account for 58% of total imports from China. These products mainly comprise electrical products, machinery and textiles.

Although China can export 568 products (at HS 8 digit) to Sri Lanka under APTA at concessional duty rates, only 16 products out of the top 100 products imported from China to Sri Lanka receive APTA concessions.³⁴ However, an analysis of imports indicates that tariffs are not a major barrier that Chinese exports face when entering Sri Lanka. Out of the top 100 products imported into Sri Lanka (at HS 6 digit), 67 products (which account for 42% of total imports from China) face tariffs lower than 5% in Sri Lanka (63 of these products face zero tariffs) (see Exhibit 6). Out of the total imports from China, 2,135 products (at HS 6 digit) – accounting for nearly 68% of total import value in 2016 – were products that could be imported duty free into Sri Lanka.

Exhibit 6: Top 100 products imported from China to Sri Lanka

	Tariffs applied by Sri Lanka					
	0-5%	>5-10%	>10-15%	>15-20%	Over 20%	Total
<i>Number of products imported from China (HS 6 Digit)</i>	67	7	14	4	8	100
<i>Value (USD Mn)</i>	1,785	212	272	53	134	2,456
<i>Value as a% of total imports from China to Sri Lanka</i>	42%	5%	6%	1%	3%	58%
<i>As a % of total imports of Sri Lanka</i>	9%	1%	1%	0%	1%	13%

Source: Calculated using data published in the International Trade Center (ITC), Trade Map, the World Integrated Trade Solutions (WITS) - World Bank, TRAINS database and the United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP), 'Trade, Investment & Innovation', APTA.

³³ Central Bank of Sri Lanka, Annual Report 2011, available at: http://www.cbsl.gov.lk/pics_n_docs/10_pub/_docs/efr/annual_report/AR2011/English/content.htm and Annual Report 2016, available at: http://www.cbsl.gov.lk/pics_n_docs/10_pub/_docs/efr/annual_report/AR2016/English/content.htm, [accessed on: February 2018].

³⁴ United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP), 'Trade, Investment & Innovation', APTA, available at: <http://www.unescap.org/apta>, [accessed on: February 2018].

This analysis indicates that the Sri Lanka – China FTA would result in higher gains for products exported from Sri Lanka to China compared to products imported from China to Sri Lanka, which are already entering Sri Lanka duty free. However, it is noted that the analysis in this report is limited to the impact of tariffs. The existence of para-tariffs, non-tariff barriers and supply side constraints (especially in relation to Sri Lanka's exports) are factors that can undermine the gains that could accrue through tariff elimination under an FTA.

ANNEX

Exhibit A1: The Scope of the FTAs

	High Income							Middle Income		
	Australia	New Zealand	Iceland	South Korea	Singapore	Switzerland	Chile ¹	Costa Rica	Pakistan	Peru
Sectors										
Trade in Goods	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Trade in Services	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Investment	✓	✓	✓	✓	✓	✓	✓ ²	x	x	✓
Other Trade Related Disciplines										
Trade Facilitation - Provisions to ensure the simplification of (reducing red tape etc.) and harmonisation international trade procedures between the signatory members.	✓	x	✓	✓	✓	✓	x	x	x	✓
Government Procurement - Provisions to assert that governments must treat foreign tenders no less favourably than local ones.	x	✓	✓	✓	x	✓	x	✓	x	x
Competition Policy - Provisions made to ensure that competition is encouraged, and anti-competitive behaviour restricted.	x	x	✓	✓	✓	✓	x	✓	✓	✓
Intellectual Property - Provisions made for the protection and enforcement of intellectual property rights such as patents, trademarks, designs, copyrights and geographical indications.	✓	✓	✓	✓	x	✓	✓	✓	x	✓
Temporary Movement of Natural Persons (TMNP) - Applicable for Trade in Services these are provisions made to reduce restrictions on the movement of natural persons from one partner country to the territory of another in order to supply a service.	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Labour Mobility - Provisions for free movement of labour between the signatory members.	x	x	x	x	x	✓	x	x	x	x
Environment - Provisions designed to protect and/or enhance the environment.	x	✓	x	✓	x	✓	✓	✓	x	x

¹It should be noted that Chile was classified as a middle-income Country at the time of signing the FTA in 2005.

²Although the UNESCAP database states that there are no Investment provisions in the Chile-China FTA, China's Ministry of Commerce website states that a supplementary investment agreement was signed in 2012.

Source: UNESCAP - Asia-Pacific Trade and Investment Agreement Database – APTIAD, available at:

<http://www.unescap.org/content/aptiad/>, [accessed on: February 2018].

Ministry of Commerce, PRC, China FTA Network, China-Chile FTA, available at:

http://fta.mofcom.gov.cn/enarticle/enchile/enchilenews/201712/36339_1.html, [accessed on: February 2018].

Exhibit A2: China's FTAs

Name	Year Enacted
<i>Implemented</i>	
China – Hong Kong	2003
China - Macao	2003
China - ASEAN	2005
China-Chile	2006
China-Pakistan	2007
China-New Zealand	2008
China - Singapore	2009
China - Peru	2010
China – Costa Rica	2011
China – Switzerland	2014
China - Iceland	2014
China - Korea	2015
China - Australia	2015
China - Georgia	2018
China - Maldives	Signed in 2017 not yet enacted
<i>Under Negotiation</i>	
Regional Comprehensive Economic Partnership (RCEP)	
China – GCC (Gulf Cooperation Council)	
China – Japan – Korea	
China – Israel	
China – Norway	
China – Sri Lanka	
China – Mauritius	
China – Moldova	
<i>Proposed/Under consultation and study</i>	
China – Nepal	
China – Bangladesh	
China – Canada	
China – Colombia	
China - Palestine	
China - Panama	
China – Mongolia	
China – Papua New Guinea	
China - Fiji	

Source: Ministry of Commerce, PRC, China FTA Network.

Exhibit A3 – Top 20 products with the highest export potential (measured in terms of the value of exports to the world) and subject to over 10% Applied Tariff Rate in China

No.	HS Code	Product Description	Effectively Applied Tariff Rate (%)	Exports to China (USD '000)	Exports to the World (USD '000)	As % of Total Exports	Exports to China as % of Total Exports to the World
1	621210	Brassieres of all types of textile materials, whether or not elasticated, incl. knitted or ...	13.00	13,949	559,026	5.30%	2.50%
2	401290	Solid or cushion tyres, interchangeable tyre treads and tyre flaps, of rubber	16.00	7,824	318,963	3.02%	2.45%
3	611610	Gloves, mittens and mitts, impregnated, coated or covered with plastics or rubber, knitted ...	14.00	1,012	246,528	2.34%	0.41%
4	620342	Men's or boys' trousers, bib and brace overalls, breeches and shorts, of cotton (excluding ...	13.00	5,384	222,824	2.11%	2.42%
5	610821	Women's or girls' briefs and panties of cotton, knitted or crocheted	14.00	1,435	222,770	2.11%	0.64%
6	611120	Babies' garments and clothing accessories of cotton, knitted or crocheted (excluding hats)	14.00	2,576	188,860	1.79%	1.36%
7	610822	Women's or girls' briefs and panties of man-made fibres, knitted or crocheted	11.00	1,203	169,269	1.61%	0.71%
8	210690	Food preparations, n.e.s.	16.00	3,406	154,326	1.46%	2.21%
9	610462	Women's or girls' trousers, bib and brace overalls, breeches and shorts of cotton, knitted...	14.00	291	138,484	1.31%	0.21%
10	620469	Women's or girls' trousers, bib and brace overalls, breeches and shorts of textile materials ...	12.00	744	135,078	1.28%	0.55%
11	610463	Women's or girls' trousers, bib and brace overalls, breeches and shorts of synthetic fibres, ...	12.00	1,271	134,253	1.27%	0.95%
12	610711	Men's or boys' underpants and briefs of cotton, knitted or crocheted	14.00	630	133,342	1.26%	0.47%
13	620462	Women's or girls' trousers, bib and brace overalls, breeches and shorts of cotton (excluding ...	14.00	1,715	127,608	1.21%	1.34%
14	401519	Gloves, mittens and mitts, of vulcanised rubber (excluding surgical gloves)	18.00	607	126,645	1.20%	0.48%
15	611020	Jerseys, pullovers, cardigans, waistcoats and similar articles, of cotton, knitted or crocheted ...	11.00	619	122,731	1.16%	0.50%
16	611241	Women's or girls' swimwear of synthetic fibres, knitted or crocheted	12.00	320	105,761	1.00%	0.30%
17	930110	Artillery weapons "e.g. guns, howitzers and mortars"	13.00	-	95,498	0.91%	0.00%
18	640610	Uppers and parts thereof (excluding stiffeners and general parts made of asbestos)	13.00	18,200	84,814	0.80%	21.46%
19	610469	Women's or girls' trousers, bib and brace overalls, breeches and shorts of textile materials, ...	12.00	1,749	68,304	0.65%	2.56%
20	090411	Pepper of the genus Piper, neither crushed nor ground	20.00	95	68,052	0.65%	0.14%

Source: International Trade Center (ITC), Trade Map