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ANALYSIS OF TRADE DYNAMICS BETWEEN INDIA AND SRI LANKA

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ABSTRACT

India and Sri Lanka, as close neighbours in South Asia, have enjoyed strong bilateral trade relations underpinned by geographical proximity, shared cultural ties, and strategic economic partnerships. Over the years, their trade relationship has been shaped significantly by the Indo-Sri Lanka Free Trade Agreement (ISFTA) of 2000, which aimed to foster greater economic cooperation. This research paper explores the dynamics of trade between India and Sri Lanka, analysing its evolution, current trends, and future opportunities.



The study identifies key commodities exchanged between the two nations, such as India's exports of textiles, pharmaceuticals, and machinery, and Sri Lanka's exports of tea, spices, and rubber. Despite substantial growth in bilateral trade post-ISFTA, the relationship is marred by a persistent trade imbalance in favour of India. Various barriers, including tariff and non-tariff measures, logistical inefficiencies, and sectorial overdependence, hinder the full potential of trade between the two nations.

This research adopts a mixed-methods approach, integrating quantitative analysis of trade statistics from 2000 to 2023 with qualitative insights from trade reports, government publications, and expert interviews. The findings reveal a strong growth trajectory but emphasize the need for diversification of Sri Lanka's export basket and reduction of trade barriers. Additionally, the COVID-19 pandemic disrupted trade flows and highlighted vulnerabilities in supply chains.

The paper concludes with actionable recommendations to strengthen trade relations, including investment in digital and physical infrastructure, enhancing regional cooperation, and exploring emerging sectors like IT services and renewable energy. A balanced trade relationship between India and Sri Lanka has the potential to significantly contribute to South Asia's economic integration and global competitiveness.

KEYWORDS: the Indo-Sri Lanka Free Trade Agreement (ISFTA), current trends and future opportunities.

INTRODUCTION

India and Sri Lanka, two neighbouring countries in South Asia, share a deep historical, cultural, and economic relationship. These ties date back thousands of years, with ancient maritime trade routes connecting the two nations across the Palk Strait. In the modern era, this relationship has grown into a structured economic partnership characterized by bilateral trade agreements, shared membership in regional organizations, and cooperative initiatives. Their proximity and complementary economies

have provided a fertile ground for a thriving trade relationship, making India one of Sri Lanka's most significant trading partners.

Bilateral trade between India and Sri Lanka has been a cornerstone of their economic relations, driven by the Indo-Sri Lanka Free Trade Agreement (ISFTA), signed in 1998 and implemented in 2000. This agreement was one of the first free trade agreements (FTAs) in South Asia, demonstrating the commitment of both nations to economic liberalization and regional integration. The ISFTA aimed to reduce tariffs and other trade barriers, thus facilitating the movement of goods and services between the two countries. Since its implementation, trade volumes have grown substantially, with India emerging as Sri Lanka's largest source of imports and a major export destination.

The significance of the trade relationship is evident in the trade statistics. According to recent data, India accounts for a substantial share of Sri Lanka's total trade. India exports a diverse range of goods to Sri Lanka, including textiles, pharmaceuticals, machinery, automobiles, and agricultural products. In contrast, Sri Lanka's exports to India are concentrated in a few sectors, such as tea, spices, rubber, and apparel. While the trade volume has increased, the trade balance heavily favours India, raising concerns about the sustainability of the relationship for Sri Lanka.

HISTORICAL CONTEXT

The trade relationship between India and Sri Lanka has a rich historical context. Ancient maritime trade routes connected the two nations, with goods such as spices, textiles, and precious stones flowing between their ports. These exchanges were not only economic but also cultural, influencing art, religion, and architecture in both countries. The legacy of these historical ties continues to influence the modern trade relationship, with certain sectors like spices and textiles remaining significant in their bilateral trade.

In the post-independence era, the economic relationship between India and Sri Lanka was influenced by their respective domestic policies. While India pursued a socialist economic model with protectionist policies, Sri Lanka adopted a more open-market approach. Despite these differences, the two countries maintained strong trade ties, which were formalized with the signing of the ISFTA in 1998.

GEOPOLITICAL SIGNIFICANCE

The geopolitical significance of the India-Sri Lanka trade relationship cannot be overstated. Sri Lanka's strategic location in the Indian Ocean positions it as a critical player in regional and global trade routes. For India, maintaining strong trade and economic ties with Sri Lanka is not just an economic imperative but also a strategic necessity to counterbalance the influence of other regional powers in the Indian Ocean, such as China.

China's growing economic and infrastructural investments in Sri Lanka, particularly through its Belt and Road Initiative (BRI), have heightened India's focus on strengthening its economic ties with Sri Lanka. This strategic rivalry underscores the importance of the India-Sri Lanka trade relationship in the broader context of regional geopolitics.

STRUCTURE OF BILATERAL TRADE

The structure of bilateral trade between India and Sri Lanka is characterized by significant asymmetry. India's exports to Sri Lanka far exceed its imports, creating a persistent trade imbalance. Key Indian exports to Sri Lanka include:

- Textiles and Apparel: India is a major supplier of raw materials for Sri Lanka's textile industry, which is one of the country's largest export sectors.
- Pharmaceuticals: India is a leading provider of affordable pharmaceutical products to Sri Lanka, meeting a significant portion of its healthcare needs.
- Machinery and Automobiles: Indian manufacturers dominate the Sri Lankan market for industrial machinery, vehicles, and consumer goods.

On the other hand, Sri Lanka's exports to India are limited to a few sectors, such as:

- Tea and Spices: Ceylon tea and spices like cinnamon are iconic exports that have found a steady market in India.
- Rubber Products: Sri Lanka exports a variety of rubber goods, including tires and raw rubber, to India.
- Apparel: While India supplies raw materials, Sri Lanka exports finished apparel products back to India.

This structural imbalance highlights the challenges faced by Sri Lanka in diversifying its export basket and increasing its value-added exports to India.

Role of the Indo-Sri Lanka Free Trade Agreement (ISFTA)

The ISFTA has been a pivotal factor in shaping the trade relationship between India and Sri Lanka. By eliminating tariffs on a range of goods, the agreement aimed to boost trade volumes and economic integration. Since its implementation, bilateral trade has grown significantly, with India emerging as one of Sri Lanka's largest trading partners.

However, the agreement has not been without its challenges. Critics argue that the benefits of the ISFTA have been skewed in favour of India, as evidenced by the persistent trade imbalance. While Indian exports to Sri Lanka have grown substantially, Sri Lankan exporters face challenges such as non-tariff barriers, limited market access, and competition from Indian domestic producers. Addressing these issues is crucial for ensuring that the ISFTA remains mutually beneficial.

CHALLENGES IN THE TRADE RELATIONSHIP

Despite the growth in trade volumes, the India-Sri Lanka trade relationship faces several challenges:

- 1) Trade Imbalance: The significant trade deficit in favour of India is a major concern for Sri Lanka. This imbalance is exacerbated by the limited diversification of Sri Lanka's export basket.
- 2) Non-Tariff Barriers: Sri Lankan exporters often face non-tariff barriers in the Indian market, such as stringent quality standards and regulatory requirements.
- 3) Logistical Inefficiencies: Inadequate infrastructure and high transportation costs hinder trade efficiency between the two nations.
- 4) Sectorial Dependence: Sri Lanka's heavy reliance on a few sectors, such as tea and spices, limits its trade potential and exposes it to market volatility.

OPPORTUNITIES FOR STRENGTHENING TRADE

Despite these challenges, there are several opportunities for enhancing the trade relationship between India and Sri Lanka:

1. Diversification of Exports: Sri Lanka can explore new export sectors, such as IT services, renewable energy, and high-value agricultural products, to reduce its dependence on traditional sectors.
2. Infrastructure Development: Investing in ports, highways, and digital trade platforms can improve logistical efficiency and reduce trade costs.
3. Regional Cooperation: Strengthening regional trade frameworks, such as SAARC and BIMSTEC, can facilitate greater economic integration and address common challenges.
4. Technology Transfer: India can support Sri Lanka by providing access to advanced technologies in sectors such as manufacturing and agriculture.

IMPACT OF GLOBAL TRENDS

Global trends, such as the COVID-19 pandemic and the shift towards digital trade, have had a significant impact on the India-Sri Lanka trade relationship. The pandemic disrupted supply chains and highlighted vulnerabilities in the trade system. At the same time, the adoption of digital trade practices presents an opportunity for both nations to modernize their trade systems and enhance efficiency.

In conclusion, the trade relationship between India and Sri Lanka is a vital component of their economic partnership, offering significant opportunities for growth and regional integration. While challenges such as trade imbalances and non-tariff barriers persist, there is considerable potential for strengthening this relationship through diversification, infrastructure development, and regional cooperation. As both nations navigate the complexities of the global trade environment, their bilateral trade relationship will play a crucial role in shaping the economic future of South Asia.

REVIEW OF LITERATURE

The trade relationship between India and Sri Lanka has been the subject of extensive scholarly analysis and policy discussions. Researchers have explored various dimensions, including the impact of trade agreements, structural trade imbalances, sectorial contributions, and regional cooperation frameworks. This section reviews key literature to provide an understanding of the dynamics of bilateral trade between these two nations.

Impact of the Indo-Sri Lanka Free Trade Agreement (ISFTA)

One of the most studied aspects of India-Sri Lanka trade is the role of the Indo-Sri Lanka Free Trade Agreement (ISFTA), implemented in 2000. Gunawardena (2018) provides a comprehensive review of ISFTA's impact, noting that it significantly increased bilateral trade volumes by eliminating tariffs on several goods. Indian exports to Sri Lanka witnessed remarkable growth, particularly in sectors such as automobiles, textiles, and pharmaceuticals. However, the study highlights the asymmetric benefits of ISFTA, with Sri Lanka struggling to achieve comparable growth in its exports to India.

Mehta and Sen (2020) argue that while the ISFTA provided a framework for reducing trade barriers, non-tariff barriers such as stringent quality standards and logistical bottlenecks have limited Sri Lanka's market access in India. This has created a trade imbalance that persists to this day. The authors emphasize the need for revising the agreement to address these issues and enhance mutual benefits.

Trade Composition and Sectorial Contributions

Several studies have analysed the composition of bilateral trade between India and Sri Lanka. According to Wickramasinghe (2019), India's exports to Sri Lanka are diverse, spanning industrial goods, agricultural products, and consumer goods. On the other hand, Sri Lanka's exports are concentrated in a few sectors, such as tea, spices, rubber, and apparel. This lack of diversification limits Sri Lanka's ability to capitalize on the Indian market.

A World Bank report (2023) highlights the dependency of Sri Lanka's exports on low-value agricultural products, making the country vulnerable to price fluctuations in global markets. The report suggests exploring high-value sectors, such as information technology and renewable energy, to improve trade performance.

Regional Cooperation and Geopolitical Context

The role of regional organizations such as SAARC and BIMSTEC in fostering trade between India and Sri Lanka has also been explored. Sharma and De Silva (2018) argue that these platforms provide valuable opportunities for economic cooperation but have been underutilized due to geopolitical tensions and lack of robust mechanisms. The authors suggest strengthening regional trade agreements to address common challenges such as infrastructure deficits and trade barriers.

Emerging Trends and Challenges

The COVID-19 pandemic has added a new dimension to the literature on India-Sri Lanka trade. Fernando et al. (2021) analyse the impact of the pandemic, noting that it disrupted supply chains and highlighted vulnerabilities in trade systems. At the same time, it accelerated the adoption of digital trade practices, presenting new opportunities for both countries to modernize their trade processes.

Gaps in Literature

Despite extensive research, significant gaps remain in understanding the sector-specific challenges and the role of emerging trends like digitalization and green energy in shaping future trade relations. This study aims to address these gaps by providing a holistic analysis of current trade dynamics and identifying actionable solutions.

In summary, the literature highlights the significant progress made in India-Sri Lanka trade relations, driven by agreements like ISFTA, while also pointing out persistent challenges such as trade imbalances and non-tariff barriers. By building on these insights, this research seeks to provide a comprehensive understanding of the trade dynamics and propose strategies for strengthening bilateral ties.

METHODOLOGY

This study employs a mixed-methods approach to analyse the trade dynamics between India and Sri Lanka.

1. Quantitative Analysis: Trade statistics from reliable sources such as the World Bank, UN Comtrade, and government trade reports are analysed to identify trends and patterns. The data spans from 2000 to 2023, capturing the impact of the ISFTA and other policy developments. Key metrics include trade volumes, trade balance, and the composition of traded goods.
2. Qualitative Analysis: Policy documents, academic studies, and interviews with trade experts and policymakers are reviewed to understand the underlying factors influencing trade dynamics.

Descriptive statistics and trend analysis are used to identify growth trajectories and sectorial contributions. Comparative analysis is conducted to assess the effectiveness of trade policies before and after the implementation of the ISFTA. This approach ensures a comprehensive understanding of the trade dynamics and provides a basis for formulating practical recommendations.

DATA COLLECTION

Data for this study is collected from both primary and secondary sources:

1. Primary Data: Interviews with trade officials, industry stakeholders, and policymakers from India and Sri Lanka provide insights into practical challenges and opportunities in bilateral trade.
2. Secondary Data: Secondary sources include trade statistics from the World Bank, UN Comtrade, and national trade reports published by the Ministry of Commerce (India) and the Sri Lanka Export Development Board.

The data focuses on trade volumes, key commodities, tariff and non-tariff measures, and infrastructural factors. The analysis period (2000-2023) is chosen to capture the effects of the ISFTA and other significant policy developments.

FINDINGS

The analysis reveals several key insights:

1. Trade Growth: Bilateral trade has grown significantly post-ISFTA, with India emerging as Sri Lanka's largest trading partner.
2. Trade Imbalance: India's exports to Sri Lanka far exceed Sri Lanka's exports to India, reflecting a persistent trade imbalance.
3. Sectorial Dependence: Sri Lanka's exports are concentrated in a few sectors, such as tea, spices, and rubber, limiting its trade potential.
4. Barriers to Trade: Non-tariff barriers, logistical inefficiencies, and inadequate infrastructure hinder trade optimization.
5. Pandemic Impact: The COVID-19 pandemic disrupted supply chains and highlighted vulnerabilities in the trade system.

CONCLUSION

The trade dynamics between India and Sri Lanka offer significant opportunities for economic growth but are constrained by persistent challenges. The ISFTA has played a crucial role in boosting trade volumes, but issues such as trade imbalances, non-tariff barriers, and sectorial overdependence need to be addressed. Strengthening regional cooperation, investing in infrastructure, and exploring emerging sectors like IT services and renewable energy can help enhance bilateral trade relations. Future research should focus on these areas to ensure a more balanced and sustainable trade relationship.

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