Impact of Relaxing Trade Barriers between Sri Lanka and India: A Computable General Equilibrium Analysis

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Sri Lanka and India entered into the Indo-Sri Lanka Free Trade Agreement (ISFTA), marking their inaugural bilateral free trade agreement in 1998. Despite fostering an improvement in bilateral trade, the advancement has been muted owing to insular policies upheld by both nations. The inclusion of a negative list and import quota has positioned ISFTA more like a preferential trade agreement than a comprehensive free trade agreement. Amid the backdrop of fortified trade relations between the two nations, there arises a necessity to reevaluate the potential repercussions of easing trade constraints. In this context, an evaluation is undertaken to assess the influence of diverse policy reforms including liberalization of agriculture sector, food and agriculture sector, and food, agriculture, and manufacturing sector on the macroeconomic and trade landscapes of both countries, employing the global trade analysis project (GTAP) general equilibrium modeling framework. The study also extends to the implications for welfare and industry output. The findings of this study indicate that relative to the prevailing scenario, liberalization of the considered sectors serves to amplify both imports and exports, thereby engendering positive effects on the real GDP. This effect is discernibly more pronounced for Sri Lanka. Additionally, the research reveals that a mutually beneficial augmentation of welfare could be achieved by both nations through the liberalization of their agricultural and food markets. However, it is suggested that Sri Lanka could potentially encounter welfare losses in the event of liberalizing the manufacturing sector. Conversely, India experiences with the most substantial welfare gains upon the liberalization of its manufacturing sector. It is advocated that due consideration be given to the liberalization of the agricultural and food sector, facilitating the mutual gains from the free trade agreement.

Keywords: food and agriculture, general equilibrium, GTAP, Indo-Sri Lanka free trade agreement

Acknowledgement: The authors acknowledge Inreach Global Ltd and Dr. Nihal Pitigala for their support.