

# **Impact of Indo-Sri Lanka Free Agreement (ISFTA) on Reduction of Poverty in Sri Lanka: A CGE Analysis**

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Although strong economic relations between India and Sri Lanka originated in pre-colonial times, economic links began to gain momentum in the 1990s with closer bilateral economic ties. Sri Lanka and India signed a bilateral free trade agreement (FTA) in 1998, which came into operation in March 2000; this was a pioneering effort towards trade liberalization in the South Asia region (Kelegama, 2014).

This study examines the potential poverty changes under the Indo-Sri Lanka Free Trade Agreement (ISFTA), through modelling the impact of various income strata of households in Sri Lanka. First, the poverty headcount in seven population stratum was calculated, along with poverty elasticity's using Household Income and Expenditure Survey (HIES) 2006/7 data. Secondly, these data were calibrated with the Global Trade Analysis Project (GTAP) database (version 8.1). Finally, we used poverty measures and AIDADS calculations to calculate poverty changes in Sri Lanka under ISFTA. We model the poverty impact of the ISFTA, under two simulations: First the elimination of all bilateral tariffs for all trade between Sri Lanka and India; and second, the elimination of all bilateral tariffs just for agricultural trade between Sri Lanka and India.

Although Sri Lanka has a very detailed and constantly changing poverty profile, very limited attempts have been made to study poverty impacts within different income groups and to capture poverty headcount changes under FTAs. Thus, modelling poverty headcount changes over seven specific income strata is a new dimension for the Sri Lankan poverty profile, which can be used to generate insights into the impacts of trade policy changes on poverty.

Our results indicate a negligible impact on overall real GDP but an impact on poverty reduction. It is estimated that full trade liberalization between India and Sri Lanka tends to reduce extreme poverty by 0.95 million and US\$2/day poverty by 4.09 million while the agricultural trade

liberalization reduces extreme poverty by 0.32 million and US\$2/day poverty by 1.13 million. Thus, it can be concluded that further liberalization under ISFTA take more people out of poverty in Sri Lanka.

**Key words:** *CGE Analysis, Indo-Sri Lanka Free Trade Agreement, Poverty Changes, Sri Lanka*

NCAS Symposium Proceedings  
2015