The Factor Content of Bilateral Trade between India & Sri Lanka

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India and Sri Lanka accounts for the largest bilateral trade flow in the SAARC region. Following India's liberalization in early nineties this bilateral trade grew by 10% per annum during 1993-99. Thereafter following India-Sri Lanka FTA the trade flows grew by over 27% from 2000 to 2006. India is now Sri Lanka's largest importer and among the top five destinations for Sri Lankan exports. Given the growing importance of this bilateral trade, the present paper attempts to study the factor contents of India-Sri Lanka bilateral trade.

The paper aims to examine whether the factor intensity of the bilateral trade have been in conformity with the pattern of comparative advantages of the respective countries as are determined from their factor endowments. Using the input-output transaction tables for Sri Lanka (year 2000) and India (year 1998-99) the paper tests empirically the Heckscher-Ohlin theory for India- Sri Lanka's bilateral trade and reports if Leontief paradox is witnessed or not. Results show that exports from India to Sri Lanka are capital intensive while imports from Sri Lanka are labour intensive. Thus, the results provide evidence to support Leontief paradox in case of India which the paper seeks to explain. The current paper also included land as a third factor of production in case of agricultural products. Researchers across the world have shown interest on similar work involving developed and developing countries. But there has not been much work involving two developing countries. The paper seeks to contribute to this gap and comes up with results that have important implications both for academic and policy-making community.