PART 1

04

COVID-19 and Impact on Export Sector in Sri Lanka

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Crisis and Fragility:
Economic Impact of COVID-19
and Policy Responses

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1. Introduction

The COVID-19 pandemic, which has killed 800,000 people and infected 22.7 million worldwide, is causing a significant impact on the global economy. Towards containing the spread of the virus, countries have taken various measures, including travel restrictions, nationwide curfews, and border closures. These have disrupted productions, supply chains as well as financial markets. The World Bank, the Organization for Economic Co-operation and Development (OECD) and the International Monetary Fund (IMF) have all released forecasts showing a significant slowdown in global economic activity, much worse than during the 2008–09 financial crisis. According to the World Health Organization (WHO), the pandemic could last for at least two years (BBC, 2020). Thus, the outlook for the global economy over the next two years is highly uncertain and this is likely to weigh heavily on trade growth.

World trade fell sharply in the first half of the year, and trade volumes will register a steep decline in 2020. The fall in trade is historically large, affecting both the demand side and supply side. The disruption to global value chains (GVCs), particularly in China, Europe, and the US, have affected crucial supplies while market disruptions have created a decline in the demand side. Exports from Asia is expected to be amongst the hardest-

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hit. However, the situation could have been far worse according to the World Trade Organization (WTO). Initial estimates by WTO showed that world trade would fall between 13% and 32% due to activity disruptions caused by the pandemic (WTO, 2020) but as things currently stand, the pessimistic scenario is less likely.

Governments and central banks around the world have enacted extraordinary fiscal and monetary policy measures to support economic activity amidst the disruptions. Policy decisions have helped in softening the blow to output and trade, and they will continue to play a significant role in deciding the pace of economic recovery. Looking ahead to 2021, adverse developments, including the second wave of COVID-19 outbreaks, weaker than expected economic growth, or widespread recourse to trade restrictions, could affect trade expansion.

This article will look at the impact of the COVID-19 pandemic on Sri Lanka, particularly its exports, policy interventions undertaken by the Government of Sri Lanka and what more can be done to help the export sector on the road to recovery.

2. Impact of COVID-19 on Sri Lanka's Exports

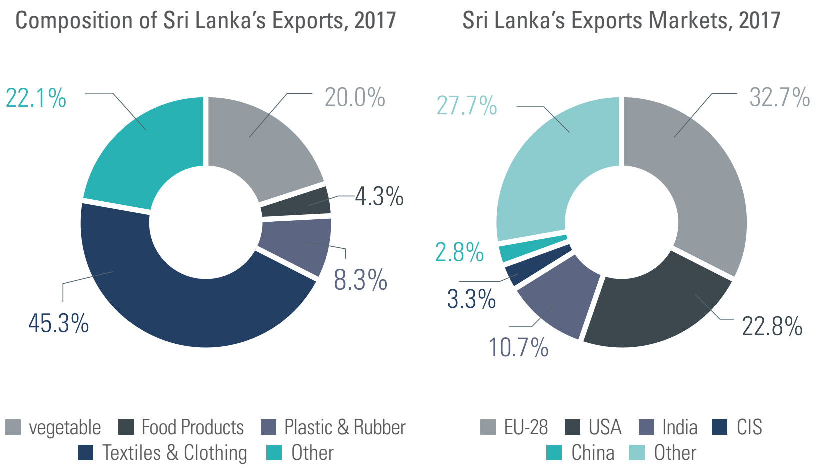
The first case of the virus was confirmed in Sri Lanka on 27 January 2020, after which there were no cases till about mid-March; thereafter cases reported increased rapidly. As of 12 September, there are 3,169 confirmed cases, 12 deaths and 2,969 recoveries reported in Sri Lanka (Health Promotion Bureau, 2020), which has been relatively successful given its population of 21.6 million in curtailing the pandemic due to early lockdown, access to a good health care system, and an established public health surveillance system (Mukhopadhyay, 2020). So far, the toll of the virus on the health sector has not been heavy. However, it is important to note that these circumstances can quickly change with cases being imported. Sri Lanka has over a million migrant workers abroad, of whom about 60,000 are wanting to return home.

Despite the relatively low cases of COVID-19, it has had wide-ranging impacts on Sri Lanka across all business sectors of the economy. To curb the spread of the virus, curfew was enforced across the island by the Government and inter-district travel was banned for two months or 52 days since the third week of March while the airport was closed and returnees were quarantined. The curfew curtailed movement of labour disrupted livelihoods and supply chains and created cash flow problems for businesses. According to estimates by the World Bank and Asian Development Bank (ADB) in April 2020 Sri Lanka's economic growth is estimated to contract by 0.5 (Newswire, 2020) and 2.2% this year, respectively. The latter figure was later revised downwards by ADB to -6.1% in 2020 with a recovery at 4.1% in 2021.

One of the pathways COVID-19 has affected countries is through disruptions to international trade (other pathways being transport and tourism, remittances, foreign financial flows). Sri Lanka as a small open economy is dependent on trade; exports plus imports account for 53 % of the GDP in 2018. As such, Sri Lanka's exports were hurt in the short-term due to the supply chain disruptions as well as the collapse in global demand for its goods and services. The EU, and the US, which are the main export destinations of Sri Lanka, and India and China, the largest import markets of Sri Lanka, are amongst the severely affected countries due to the coronavirus. The EU and US account for 33 and 25% of Sri Lanka's exports, respectively, followed by India. In terms of imports, India and China provide 21 and 20% of Sri Lanka's total imports in 2017 (World Integrated Trade Solution, 2020). The situation has not been helped by the fact that Sri Lanka's export markets and products are highly concentrated, as shown in Charts 1 and 2. The poor economic performance of the key trading partners has not only affected Sri Lanka's export earnings but caused supply disruptions which will, in turn, impacted the country's export capacity (Central Bank of Sri Lanka, 2020). Moreover, Sri Lanka's imports exceed exports over the years, leading to a deteriorating trade balance; exports cover about half of the imports while the rest has to be covered by foreign remittances and earnings from tourism, both of which have been severely affected by COVID-19.

Chart 1 & 2.

Composition of Exports and Export Markets of Sri Lanka



Source: Source: WITS, 2020

According to a survey on trade and labour market impacts of COVID-19 by the Ceylon Chamber of Commerce (2020), three key challenges highlighted by export firms at the height of the crisis in the country included: difficulties in the continuation of overall business operations, lack of operational cash flow and decline in workers' production or productivity due to working from home or termination of employment. With the containment of the spread of the virus and normalization of economic activity by mid-2020, however, firms expect a slow recovery towards the latter part of the year.

The apparel and textile industry, one of the highest contributors towards national exports (45 % of total exports) and a significant employer (supporting livelihoods of almost one million workers), are amongst the most affected sectors in Sri Lanka (PWC, 2020) due to plunging in demand in its key markets (the US and EU) and supply disruptions of raw materials in addition to production disruptions due to island-wide lockdown, which has since been eased. In early March, the industry was facing supply shortages of raw materials because of the outbreak of the virus and factory closures in China, a major supplier to Sri Lanka – China supplies 40% of Sri Lanka's textile imports. On 19 March, Sri Lanka went into island-wide lockdown and factories were closed till the end of

April. Factories were gradually opened from early May but were operating below capacity, due to health restrictions imposed by the government and the ad-hoc manner in which the restrictions were eased. Further to the supply and production disruptions, with lower consumer spending in the affected markets, buyers were cancelling orders, refusing to accept shipments, and unilaterally extending the payment terms, which affected the cash-flow of firms (Rodrigo, 2020) and their ability to pay suppliers and wages, especially SMEs. Workers in the apparel industry have lost their jobs while others have experienced salary reductions due to loss of incentives, bonuses, attendance allowances, and overtime. Whilst Sri Lankan factories were closed, competitor countries like Vietnam and Cambodia continued to operate, which hurt the industry as new orders were placed with them. In 2019, the industry earned USD 5.1 billion from exporting apparel (Dinesh, 2020). Due to COVID-19, a revenue loss of USD 1.5 billion is estimated for the second quarter alone even though the health crisis has opened new opportunities in the manufacture of personal protection equipment (PPE)[1].

Since the COVID-19 outbreak, the global supply chain for PPE has not been able to adequately cope with the surge in worldwide demand. Constraints in supply and logistics, including export bans on PPE and materials, have contributed to a global shortage of PPE together with abrupt supply disruptions in China, a major producer of PPE. In light of the surge in international demand for PPE, the Sri Lankan apparel industry is switching to the production and export of PPE as international orders for regular items of clothing dry up.

Also, the export of commodities such as tea, coconut, rubber, spices and food and beverages were heavily impacted due to the pandemic. Total exports were down 26% in the first half of 2020 in comparison to last year (Table 1). However, some sectors are starting to see some growth after the lockdown ended. For example, in the month of June, the export of tea, coconut-based products, spices and essential oils, fish and fisheries products were up (economynext, 2020). Sri Lanka's seafood exports have experienced strong demand and higher prices despite the global crisis and higher air freight rates. Seafood exports from Sri Lanka include fresh and frozen yellowfin tuna, shrimp, prawns and crabs. The main markets for Sri

1. Personal protective equipment (PPE) refers to protective clothing, helmets, gloves, face shields, goggles, facemasks and/or respirators or other equipment designed to protect the wearer from injury or the spread of infection or illness.

Lanka are Europe, US and Japan but with the crisis, there has been a shift in products (from fresh to frozen) and the emergence of new markets closer to Sri Lanka such as the UAE, Singapore, Malaysia (Mahadiya, 2020).

Despite the huge drop in tea exports in March by as much as 50% with closures (Daily News, 2020), the outbreak of COVID-19 also has led to a positive outcome in the tea industry with the digital transformation of the 126-year-old tea auction which was up to recently done manually over the course of two days in the week. Tea auction is a crucial channel in the tea value chain with almost all of the tea produced in the country sold through the auction (Neo, 2020). Digitizing the tea auctions has been in discussion for 20 years, but the pandemic catalyzed the shift as the curfew declared on March 20 made it impossible to hold physical tea auctions. Moreover, the global demand for tea is expected to rise, as studies show that black tea may help boost immunity (Illanperuma, 2020). Main markets of Sri Lankan tea include Turkey, Iraq, Russia, Iran, Azerbaijan, and China, which is emerging as a top buyer of black tea (Tea Exporters Association, 2020).

While everyone was affected, export-oriented Small and Medium Enterprises (SMEs) were worst hit, as they are less equipped to face order cancellations and prolonged demand decline. Considering the unprecedented disruption to the global economy and trade due to the COVID-19 pandemic, the Sri Lanka Export Development Board (SLEDB) revised its 2020 exports forecast by a hefty 42% to $10.75 billion, down from the target of $18.5 billion. Despite the uncertainty and severe disruption to business in the immediate/short term, many exporters expect the situation to improve over the next 12 months (Ceylon Chamber of Commerce, 2020).

Table 1.
Export Performance, First Half of 2019 and 2020

Product	2019 Jan-June	2020 Jan-June	% Growth	2019 June	2020 June	% Growth
Apparel & Textile	2753.58	1936.66	-29.64	503.91	402.04	-20.22
Tea	684.95	571.66	-16.54	113.18	114.93	1.55
Coconut & Coconut-bases Products	314.05	281.61	-10.33	54.53	65.01	19.22
Rubber & Rubber-based products	457.11	349.17	-23.61	80.80	68.89	-14.74
Electrical & Electronic Products	195.38	144.11	-26.24	33.14	31.06	-6.28
Food, Feed & Beverages	193.06	156.28	-19.05	34.47	31.59	-8.36
Spices, Essential Oils & Oleoresins	144.09	114.49	-20.54	24.40	31.71	29.96
Fish & Fisheries Products	151.61	105.5	-30.41	22.50	26.30	16.89
Fruits, Nuts and Vegetables	37.08	30.59	-17.50	5.57	6.72	20.65
Cut Flowers & Foliage	10.09	6.64	-34.19	1.73	1.47	-15.03
Other Export Crops	14.38	39.16	172.32	2.56	9.30	263.28
Diamonds, Gems & Jewellery	157.79	71.16	-54.90	23.28	10.13	-56.49
Footwear & Leather	46.14	17.3	-62.51	5.73	3.56	-37.87
Base Metal Products	90.69	55.46	-38.85	13.83	9.63	-30.37
Petroleum Products	165.66	170.65	3.01	32.21	29.64	-7.98
Others	515.08	311.9	-39.45	132.17	64.04	-51.55
Total	5929.74	4362.34	-26.43	1084.01	906.02	-16.42

Source: Sri Lanka Export Development Board

3. Policy Responses

The Government of Sri Lanka has stepped in and allocated via the Central Bank of Sri Lanka (CBSL), LKR 50 billion, which was later increased to

LKR150 billion under a Saubagya COVID-19 renaissance facility to support local businesses, and individuals affected by the pandemic. Major concessions have included debt moratorium for loans/leases, overdraft facilities, rescheduling of non-performing loans and granting of new loans. Sectors eligible for concessions include SMEs (small and medium enterprises); tourism, direct and indirect export-related businesses; self-employed businesses and foreign currency earners. The government has also allowed a delay in the payment of ETP (Employment Trust Fund) and EPF (Employment Provident Fund) (Rodrigo, 2020). However, such measures are limited in scope.

Sri Lanka was performing poorly on the economic front even before the outbreak. GDP growth was the lowest in almost a decade (2.3%) in 2019 while the budget deficit and public debt were quite high – 6.8% and 87%, respectively (Weerakoon, 2020). Also, a huge amount of foreign debt settlement of USD4 billion per year is due over the period 2019-2022. Constraints on fiscal space and high levels of public debt have limited the government's ability to mobilize resources. Fiscal space was already constrained due to a large tax relief package – estimated to about 20-25% of existing revenues – delivered before the COVID-19 outbreak, following the Presidential Elections in November 2019 (Weerakoon, 2020).

At the same time, on the monetary front, the Central Bank of Sri Lanka has reduced lending/borrowing rates and increased liquidity in the market by reducing the statutory reserve ratio of banks to support economic activity, and resorted to extraordinary measures to shore up their foreign currency reserves and ease the pressure on the exchange rate/balance of payments by suspending purchases of foreign currency bonds by Sri Lankan banks and banning imports of 'non-essential' goods, which have created supply chain bottlenecks and affected export-oriented industries dependent on imported inputs (Hamza, 2020). The import control and movement to protectionism in support of local agriculture and industrial production is concerning given that Sri Lanka's economy and exports require imports for its growth and competitiveness. Subsequently, the government allowed imports of essential raw materials for production of value-added products for export orders. However, many businesses catering to the domestic market which depended on imported inputs are scrambling to find alternatives for cost-effective production.

Other than the above fiscal and monetary policies, a Presidential Task Force on COVID-19 was set up to monitor and prevent the spread of the disease, and ensure essential services in the country while relevant trade supporting agencies in the country including the Export Development (EDB), the Department of Commerce (DOC), Sri Lanka Customs have been assisting exporters in various ways to mitigate the negative effect of COVID-19 on the trade with a skeleton of staff during the height of the crisis in the country. EDB for example has set up a help desk to resolve urgent issues facing exporters, providing information on best practices, state concessions, logistics and fast-evolving global markets with support of Sri Lankan diplomatic missions and embassies around the world. In the meanwhile, SLC introduced new working hours, measures were taken to continue providing custom services whilst adhering to social distancing protocols, facilitating importations of relief and essential commodities (and progressively started processing other transactions, including the importation of raw materials or semi-manufactured goods to be processed for re-export), accelerating the movement to paperless process, whereby trade operators and relevant regulatory agencies can now submit supporting documents and approvals electronically to Customs (Jayaratne, 2020).

At the regional level, leaders of South Asia met online in March to discuss a regional response to the COVID-19 crisis through the regional organisation, South Asian Association for Regional Cooperation (SAARC). Countries adopted a range of steps including provisional clearance of imports from the region at preferential duty and acceptability of digital documents, and resolving issues on exports/imports at customs to facilitate intra-regional trade (SASEC, 2020). In addition to other measures, a USD22 million SAARC COVID-19 Emergency Fund was constituted to cushion the impact of the pandemic; Sri Lanka pledged to contribute USD5 million to the Fund.

Despite the above domestic policy measures, there have been criticism/ questions about their access and effectiveness (Fernando, 2020). For example, CBSL and banks have extended loans under the newly established facility for COVID-19, but the ground reality may be that larger businesses or those which have a solid working relationship with banks/bank managers will have better access and refinance their previous loans while those who truly have finance needs (like SMEs and others who were severely affected by the COVID-19) may not benefit or get crowd-out. Also, banks have a higher incentive to deposit with CBSL and simply earn higher interest with minimal administration cost, rather than providing a loan facility at lower interest to customers. Banks have been also reluctant to take the risk to provide loans in a challenging environment due to fear of default while banks' credit approval systems and delays in banks' internal approvals for loans have not helped the situation, given the urgent need of such facilities and higher demand for loans.

4. Way Forward

Economic contraction in major markets will adversely affect the demand and prices of Sri Lanka's key export categories (apparel, tea, spices, rubber, coconut, seafood, etc.) with intensified competition from lower-cost producers (Bell, 2020). In this context, Sri Lanka's exporters need to focus on differentiation, value-addition, branding, and quality rather than quantity as espoused by the Government of Sri Lanka. Sri Lanka's leading export firms in most sectors are already doing this but they need to redouble their efforts, as still a lot of goods go out of the country in raw/bulk form. For example, although Sri Lanka is an important producer and exporter of tea to the world, only 40 percent of the tea goes out of the country in value added form. With consumers increasingly concerned about the environmental and social impacts of the goods they buy; Sri Lankan exporters need to differentiate their products along these lines. Towards this end, it is important to strengthen and support the export of quality and value-added products from the country.

The global shutdown as well as the supply disruptions caused by COVID-19 have made many companies recognize their over-reliance on supplies from China (Bell, 2020). These companies are now actively seeking new suppliers and manufacturing locations outside of China with the rising cost of production in China and to diversify their supply-chains and risk – from electronics and appliances to auto-parts and precision components, to textiles and garments. There is an opportunity for countries like Sri Lanka to benefit from supply chain disruptions and realignment, which is currently underway. Sri Lankan firms with capabilities in these sectors together with the government need to attract these global companies seeking alternate manufacturing or sourcing locations. Developments like Colombo Port City, the export processing zone near Hambantota in the South, and the proposed dedicated textile industrial park in Eravur in the East of Sri Lanka provide further opportunities to pitch Sri Lanka as an ideal location for relocation of major manufacturing facilities from China.

To take advantage of these supply shifts, Sri Lanka will have to articulate industry specific strategies, identify areas to improve in the country for investor consideration, and sell Sri Lanka as a destination to specific companies seeking to diversify their supply chains (Deloitte, 2020).

With COVID-19 pandemic and social distancing, working remotely has dramatically increased digitization of knowledge-based services. These services can now be delivered remotely via online from anywhere in the world. Sri Lanka is already supplying software which runs the world's top stock exchanges, airlines and retailers, and accounting services that support the back office of leading banks and insurance companies (Bell, 2020). The pandemic has made more people around the world including Sri Lanka comfortable with sourcing online services including medical consultations, legal advice, accounting services, etc. Since Sri Lanka has long been known as a supplier of top-quality doctors, lawyers, engineers and accountants, there is a huge opportunity for Sri Lankan professionals to export these services to the world online. The Sri Lankan government can still do more to support the growth of the sector by improving its legal framework for a digital economy (consumer protection, data privacy, cyber security), providing access to affordable digital infrastructure, implementing educational reforms which ensure that firms can source sufficient talent and accelerating digitization of government processes and its departments. The pandemic forced many government processes/procedures to go online: from the tea auctions to customs clearances. The government needs to further digitalize its departments and services which will mitigate the adverse effects of COVID-19 and facilitate cross-border trade.

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