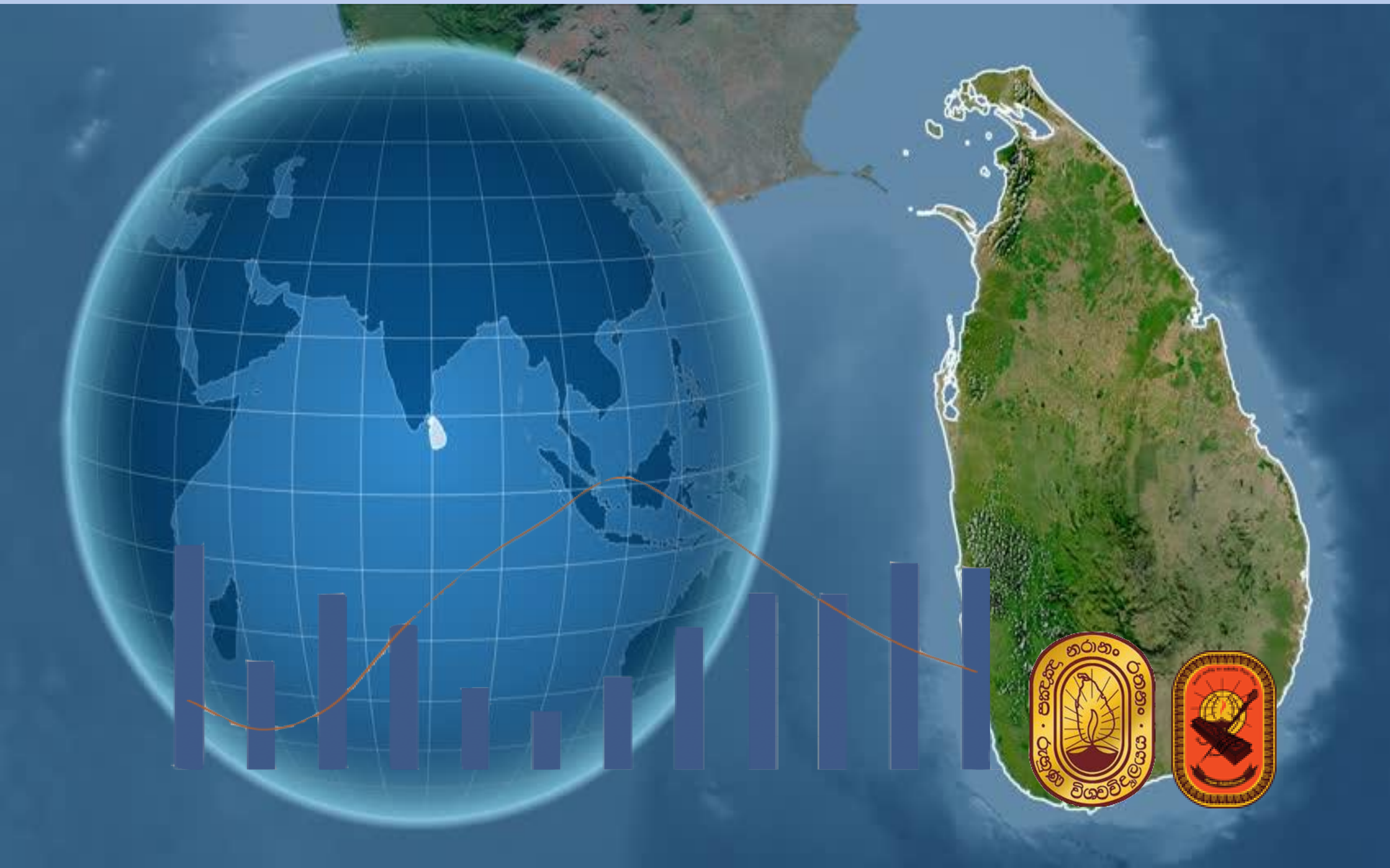
UNIVERSITY OF RUHUNA

FACULTY OF HUMANITIES AND SOCIAL SCIENCES

COVID-19: THE SOCIO-ECONOMIC IMPACT ON SRI LANKA

Part-I
The Economic Impact of the COVID-19 Pandemic in Sri Lanka



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Faculty of Humanities and Social Sciences,
University of Ruhuna,
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We are particularly grateful for the anonymous respondents who contributed by providing information and views during the online survey. Special thanks go to high-ranking government officials and experts in ministries, agencies, and departments in Sri Lanka who provided valuable information to complete this report.

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ABBREVIATIONS

ADB	Asian Development Bank
ASPI	All Share Price Index
ATPS	Alternative Tax Payment System
BOI	Board of Investment of Sri Lanka
CBSL	Central Bank of Sri Lanka
CEO	Chief Executive Officer
COBP	Country Operations Business Plan
COVID-19	Coronavirus Disease 2019
CPC	Ceylon Petroleum Cooperation
CPI	Corruption Perceptions Index
CRB	Cooperative Rural Banks
CSE	Colombo Stock Exchange
DFI	Development Finance Institutions
EPZ	Export Processing Zone
EU	European Union
FDI	Foreign Direct Investment
FTSE UK	Financial Times Stock Exchange
GDP	Gross Domestic Product
GICS	Global Industry Classification Standard
GOSL	Government of Sri Lanka
GSP+	General System of Preference
HDI	Human Development Index
HPB	Health Promotion Bureau
ICT	Information and Communications Technology
IMF	International Monetary Fund
Ind. Park	Industrial Park
IRU	Investor Relations Unit
IT - BPO	Information Technology - Business Process Outsourcing
JAAF	Joint Apparel Association Forum

JVP	Janatha Vimukthi Peramuna
LCB	Licensed Commercial Banks
LKR	Sri Lankan Rupee
LTR	Local Trust Receipt Loans
LTTE	Tigers of Tamil Elam
MDGs	Millennium Development Goals
MSCI	Morgan Stanley Capital International
MSMEs	Micro, **S**mall and Medium-scale Enterprises
MTI	Medical Training Initiative
NAM	Non-Aligned Movement
NBT	Nation Building Tax
NPLs	Non-Performing Loans
PAYE	Pay As You Earn
PHCR	Poverty Headcount Ratio
PPE	Personal Protective Equipment
PPPs	Public-Private Partnership Strategy
ROA	Return on Assets
ROE	Return on Equity
SAARC	South Asian Association for Regional Cooperation
SBS	*Samurdhi* Banking Societies
SEEDS	*Sarvodaya* Economic Enterprise Development Services
SLTDA	Sri Lanka Tourism Development Authority
SLTPB	Sri Lanka Tourism Promotional Bureau
SME	Small Medium Enterprises
SOE	State Owned Enterprises
SRR	Statutory Reserve Ratio
TCC	Thrift and Credit Cooperative Societies
TD	Tourism related discussions
UN	United Nations
UNDP	United Nations Development Programme
UNHCR	United Nations High Commissioner for Refugees

UNICEF	United Nations International Children's Emergency Fund
UNWTO	United Nations World Tourism Organization
USAID	United State Agency for International Development
USD	United States Dollars
VAT	Value Added Tax
WB	World Bank
WFH	Work From Home
WHO	World Health Organization
WHT	Withholding Tax

EDITORIAL NOTE

One of the key roles of university academics is to carry out research; either pure or applied. While the pure or fundamental research advances the frontiers of existing scientific knowledge, applied research attempts to find solutions to practical issues or challenges faced by people in their everyday life. In reality, however, both pure and applied research are interrelated and interdependent, each type contributing to the advancement of the other.

The threat enforced by the COVID-19 pandemic is probably one of the biggest challenges ever faced by humanity. The novel Coronavirus, as it is generally known, has threatened the entire world, irrespective of social and economic background. The main focus of the world today, therefore, is either to eradicate the virus or overcome its effects on society at large. Experts in the medical field across the world are working tirelessly and collaboratively to find vaccines for the virus, others are researching on the possible effects of the virus on various aspects of society. The present work falls into the second category.

The Faculty of Humanities and Social Sciences of the University of Ruhuna, in keeping with its academic and social responsibility, initiated a research project to study the Socio-economic impact of the COVID-19 pandemic in Sri Lanka. The aim of this research was to understand the effects of the COVID-19 pandemic on the economy and society in Sri Lanka and make viable policy recommendations to overcome them.

This research was undertaken as two separate, but interlinked research projects, under an Overall Coordinator and two Subject Specialist Coordinators, each comprising its own team of researchers, selected to represent various aspects of economy and society. The outcomes of this research are presented as two separate reports. The present report is Part I: The economic impact of the COVID-19 pandemic in Sri Lanka, while the other is Part II: The social impact of the COVID-19 pandemic in Sri Lanka. This second aspect of the research should also be considered as an integral part of our overall research and the reader is encouraged to consult both reports to understand the bigger picture of the effect of the novel Coronavirus in Sri Lanka.

The present report deals with the economic impact of the COVID-19 pandemic in Sri Lanka. The impact of the virus on the economy was looked at at two levels: The Sri Lankan economy as a whole, and individual households. In the first category, key state and private sector economic aspects -- 19 different sectors --were considered. The smallest unit of the economy, household livelihood, is vital for the economy of the island and this research paid adequate attention to that as well. In terms of the impact of COVID-19 at the individual level, the public sector employees were the least affected. In comparison, employees in the service sector and those employed in micro or family enterprises, as well as daily-wage-workers were severely affected. This research reveals that the impact of the COVID-19 in many aspects of the Sri Lankan economy, however, is temporary. Several sectors, such as travel and tourism, are likely to have mid to long-term effects of the Coronavirus. The policy recommendations made in this report are based on careful analysis of research findings and deserve the serious attention of policy makers.

The Coronavirus delinked the so-called 'globalized world village' into isolated entities. Even the next-door neighbours were physically disconnected from each other. It is the technology, through its ability to create virtual links, which keeps the world together. The effects of the Coronavirus are also reflected in the research strategy adopted in the present study. As is evident from the chapter on Research Methodology, the entire research was carried out using virtual questionnaires and interviews. The research team could not meet physically and all planning and implementation, as well as data analysis and the writing of the research outcomes were undertaken by the team members in physical isolation. Consequently, the compiling of this report was, in a way, 'piecing together' fragmentary chapter sections written by many individuals in seclusion. This challenging task was done by Dr Nisantha Kurukulasooriya and Dr Nandasiri Keembiyahetti, the Subject Coordinator and the Overall Coordinator, respectively, with whom I had a great understating during the entire process. This made my task, as editor, more easy, but my challenge was to bring uniformity to this 'piecemeal writing', so as to present a coherent picture. I wish I had adequate time to accomplish this task. We were all, however, compelled to keep to a tight timeline. The language editor, Dr D.V.N. Harischandra, had her own challenge to edit the entire report in less than three days. And economics is not even being her field of specialization; neither is it mine. Similarly, Mr W.A.N.D. Wijesinghe had an even shorter period of time to format the entire report. Thus, the entire team involved in this endeavour had to work under severe stress and the constraints enforced by the lockdown and 'stay at home' situations. Pressure to finish the report and make policy recommendations without delay, while also performing the assigned university duties of the team members was exhausting. This report is the outcome of our struggle to accomplish research objectives under these circumstances and the reader is the best judge of our efforts.

The final aim of this research project is to bring a comprehensive research volume where it is expected that the limitations of the present volume are overcome.

I wish to express my sincere gratitude to the Overall Coordinator, the Subject-specialist Coordinator, the Language Editor and the team of contributors, as well as the participants of this research project, without whose assistance this report would not have been possible.

Wijerathne Bohingamuwa, MPhil (Cantab), PhD (Oxon)
Editor-in-Chief

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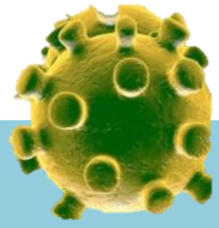


Executive summary

The COVID-19 pandemic has made an unprecedented threat on both the health status and the smooth functioning of economies in the world, and Sri Lanka is no exception. The outbreak was hindered on all facets of economies creating unprecedented challenges to policymakers with the presence of liquidity crisis, employment layoff, disturbances on international trade, and bans on travel and tourism.

The direct health impacts are significantly low in Sri Lanka compared to the other regions of the world, particularly in Asia. There were 2770 confirmed cases, 653 active cases in hospitals with 11 deaths while 2106 recovered and discharged from hospitals as of 26th July 2020 in Sri Lanka (Health Promotion Bureau, 2020). The impact of the ongoing pandemic severely affected and further worsened the livelihood of individuals and families in the country with the enforcement of continued islandwide curfew, cross-border mobility restrictions, lockdown of the country and regulations such as social distancing and other health precautions.

The current situation has created an urgent need to assess the economic impact of the COVID-19 on Sri Lankan households to identify the way to mitigate the impacts of the crisis. The University of Ruhuna decided to conduct a rapid survey to achieve the needful. An online survey was conducted to investigate the micro-level impact with a sample of 1087 respondents from 22 administrative districts in Sri Lanka. Further, in-depth interviews with experts in many sectors were also conducted to evaluate the micro-level impact of the pandemic with an enormous review of current literature. Following are the highlights of the research.

Seven per cent of the households lost their income entirely while the income loss for the rest of the households is temporary.

Income loss is impermanent and not painful

The income sources of 64% of the households have been affected while 7% lost their entire income. The research concerned the household conditions but not the individual income status. There is no association between change of income and change of job status after the COVID-19 outbreak and thus the loss of household income will be temporary loss of their jobs and other income sources.

However, 3% of households lost their entire livelihood due to the pandemic.

Changes of expenditure and savings are provisional

Education, transport, entertainment expenditure, medicine and loan repayment expenditure significantly declined and it can be assumed that all these changes are provisional and thus people will be on the pre-pandemic track in the post-COVID-19 period. Electricity bills, internet cost and donations have noticeably increased. Two per cent of households experienced net losses instead of savings and the loss was estimated to LKR 60,000 per household on average per month during the period of the economic lockdown. Fifteen per cent of households reported no losses or no savings. Average savings amounted to LKR 70,000 while the median savings per household amounted to LKR 20,000.

The estimated loss due to economic lockdown is LKR 60,000 per household on average per month.

The COVID-19 has not created a debt trap

No change in debt liabilities was reported in 79 % of the households whereas only 6 per cent of the household has fallen to indebtedness due to the COVID-19 outbreak. The COVID-19 has not created a debt trap for many of the households in Sri Lankan economy. Five to ten per cent of the households borrowed on loan repayments and daily consumption needs while a very small percentage of households borrowed for medical treatment and bill payments. Just 8% of households are seeking support for repayments of loans borrowed during the pandemic.

Only 6 per cent of the household has fallen to indebtedness due to the COVID-19 outbreak.

Day payment workers are mostly vulnerable

Approximately 82% of households were resilient to the crisis since they were fixed income earners. Seven per cent of the household heads totally lost their employment. Ninety-two per cent of the respondents claimed that daily basis workers were mostly vulnerable to pandemic shocks while, 80% claimed that three-wheeler owners are also vulnerable. However, the loss for many other segments is not limited to the income foregone, but includes the fixed cost they have to bear (monthly rental for business premises) even in the absence of income.

Fixed salary holders are safe and daily basis workers are the most vulnerable to pandemic shocks.

No harm on household assets base

Approximately 10% of the households have mortgaged their jewellery and related items such as mobile phones to solve temporary liquidity problems and there was no substantial effect on other types of real assets. Cash balances and current/savings account balances markedly declined. On part of the liabilities, credit card outstanding balances, borrowings and procrastinated leasing instalments have considerably increased.

The COVID-19 changed lifestyles of households

Sri Lankans have changed their attitudes and practices with the effect of the new COVID-19 outbreak. Nearly 75% of households are ready to continue with the activities initiated during the post-COVID-19 period, including home gardening. Forty-six per cent of households have understood that they are wasting foods and consumables. It was revealed that smoking and alcohol usage would not be reduced.

Debt moratorium just a cushion for financial difficulties

More than 50% of households are refusing financial assistance during the post-COVID-19 period while around 45% of households are seeking financial support for loan repayment, redeeming mortgaged items, paying outstanding credit card balances and other bill payments. The current debt moratorium introduced by the Central Bank for three months will provide only a cushion, the liabilities will be accumulated and both borrower and the lending institution will be in trouble after three months, unless the borrower's income sources are regained.

Households opt for mutual assistance in the new normal

About 55% of the households refuse any kind of technical assistance since they have no permanent damage due to COVID-19. Forty-five per cent of households are expecting some type of advice for their betterment and thus government intervention is important. Formal or informal organizations, which are called social capital formation, play an important role in disaster situations like the COVID-19 outbreak. Therefore, 78% of the households have opted to form such an organization in the neighbourhood for mutual assistance among communities.

Credit card outstanding balances, borrowings and procrastinated leasing instalments have considerably increased.

The proposed debt moratorium cannot provide concrete solution for financial difficulties.

The COVID-19 encumbers on MSMEs

The events and activities related to production and employment of most of MSMEs are significantly hit by the COVID-19 pandemic. Approximately 80% of enterprises were exposed to suffer a production and employment drop. More than 80% of the MSMEs declined their sales due to delayed or cancelled orders by domestic and foreign buyers. The most severely affected enterprises were the "accommodation and foodservice sector" which is the major part of the tourism industry. Approximately 10% of MSMEs in the apparel and textiles industry in Sri Lanka have shifted their production towards protective clothing such as face masks under the pandemic environment. Nearly 15% of MSMEs have benefited under the current crisis. Retail and wholesale trade, *Ayuravedic* medicine activities, and computer sales have been continuing their business without a significant drop in sales. To overcome the current sluggish situation, the government and other responsible institutions should initiate a sound policy guidance.

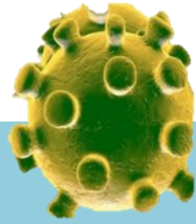
Far-reaching consequences on Sri Lanka's stock market

The COVID-19 pandemic has kept investors in suspense since February, placing markets in high levels of volatility, divestments, and flight into "safer haven assets". Similar to other economies, uncertainty over economic slowdown in Sri Lanka, led to a sell-off in the financial market and capital outflows. Market analysts expect this situation to continue until the market settles down as both local and foreign investors are looking at exiting from risky assets due to the global pandemic. The foreign investors must have taken into consideration the fact that Sri Lanka has been downgraded by international credit rating agencies as well. Despite the foreign selling pressure, the CSE turned up and showed a little improvement after 12th May. This implies that investor sentiments are becoming positive gradually.

Despite the foreign selling pressure, the CSE turned up and showed a little improvement after 12th May. This implies that investor sentiments are becoming positive gradually

The gloomy prediction on textiles and garment sector

The textiles and garment industry recorded USD 5.6 billion of export earnings in 2019. The estimated losses for the 3 months' period from 15th March to 15th May round up to USD 1,400 million. The most alarming signal is that 45% of the Sri Lankan export market depends on the USA, which is the most COVID-19 affected country in



the world, followed by UK (14%), Italy (8%), Germany (6%), the second most severely the COVID-19-hit countries. Demand contractions could result in a reduction of apparel exports by an additional 30 - 40% after June, due to mass cancellations of orders by buyers and problems in the purchasing of necessary raw materials. These circumstances, coupled with delayed shipments, forced discounts, and currency depreciation, have led to working capital problems across the industry.

The COVID-19 threatened the construction sector

The construction sector was already suffering from delayed payments for government financed projects and lower demand for high-end condominium developments. On this backdrop the construction sector would face constraints in meeting contractual agreements on completion dates and costs. While the labour and related issues would also affect the performance of the construction sector in the short run due to health standards, raw material-related issues are also expected with the imposition of import controls. In order to re-energize the construction sector, measures to pay off already delayed payments for completed projects and carefully crafted policies to address the aforementioned issues are timely important.

Reduction of apparel exports by an additional 30 - 40% is expected after June.

The changing lifestyles and income levels sharply affected the consumer goods industry.

The COVID-19 limits consumption

The consumer goods sales volume of large-scale institutions crashed while the medium and small-scale businesses were willing to normalize within several weeks after the lifting of the curfew. The production capacity dropped by 50% as a result of the working from home concept. The supply chain and the reinvestments of the industry are at risk because of the profit loss and shrinking cash flows. The changing lifestyles and income levels sharply affected the consumer goods industry. The industry has to find new ways to reach the customer in a more efficient manner.

Travel and tourism in Sri Lanka hit the ground

Travel bans, mobility restrictions, lockdowns and border closures disrupted global travel with the pandemic outbreak. Sri Lanka's tourism was also significantly affected. Tourist arrivals reached bottom line. The expected loss of revenue is more than USD 300 billion. Zero income resulted in the layoff of temporary and casual

Travel and tourism in Sri Lanka is bad affected.

Approximately 20% of indirect employees entirely lost their earning sources.

Zero income of tourism created a financial distress to investors who were trapped by indebtedness despite the loan moratorium granted.

employees, while permanent employees are also in high risk of job loss with the current salary freeze. Approximately 20% of indirect employees lost their earning sources. Zero income created a financial distress to investors who were trapped by indebtedness despite the loan moratorium granted for a few months. Investors are likely to leave the industry though there are no threats on mortgaged property to foreclose. Stakeholders will indeed be relieved in 2021 if there are no more disasters. Regaining tourism entirely depends on the source markets' recovery and on the safety brand of Sri Lanka. Thus, Sri Lanka has to harness new avenues in tourism.

The COVID-19 weakened already-fragile fiscal position

With recent amendments in the tax laws the exact impacts of the COVID-19 economic shock on revenue collection must be studied carefully. The real impact of the pandemic will be seen towards the end of the fiscal year as indicated in distribution of tax collection during a year. All in all, the as far as the fiscal policy is concerned, prolonged fiscal deficit is highly likely to further escalate during the year. Thus, the greatest challenge in financing this deficit is not to crowd out the private investment which will cost the future economic growth in the country on one hand, and one other hand, not to expand external financing to an unmanageable level, which will risk both future growth and the sovereignty of the country. Standard and Fitch ratings downgraded Sri Lanka sovereign credit ratings to B-. This would weaken Sri Lanka's already-fragile fiscal position as the credit facilities will be tightened by international sources.

Government relief package kept the aggregate demand from sinking

The fiscal position of the government has weakened following the unexpected allocations for health facilities, imposing price ceilings for essential food items, relief funds, strengthening social nets and doubling household transfer payments during the lockdown. Household transfers which account for 18% of recurrent expenditure for a normal fiscal year, would have increased by nearly 2% this year. During the COVID-19 pandemic period, tax collection delayed. As a solution to the liquidity problem, the government continued printing money in substantial amounts. For the two months ending 30th April

2020, the government has printed money more than LKR 200 billion, threatening price stability of the country. However, this helped a lot in sustaining the aggregate demand at the required level to keep the economy on the move in a distress situation where the vast majority has lost their income sources.

Banking and finance sector at a risk of increasing NPLs

On the one hand, while the assets quality of the banking sector is expected to go down, the demand for credit will also go down, as almost all leading sectors are confronted by the pandemic. On the other hand, Non-Performing Loans (NPLs) are expected to go up in the short and medium terms, which can be risky. Even though various regulatory measures have already been taken by the Central Bank to give a positive shock to economic activities, the effectiveness of such policies in reaching the expected outcomes is questionable. Moreover, the most recent policy directions issued by the Central Bank show that they are yet to address the real issue in the system. Therefore, to reach the benefits of the revival policies while ensuring the soundness of the financial system, it is expected to face the trade-off between economic growth and price stability.

The most recent policy directions issued by the Central Bank show that they are only cushions yet to address the real issue in the system.

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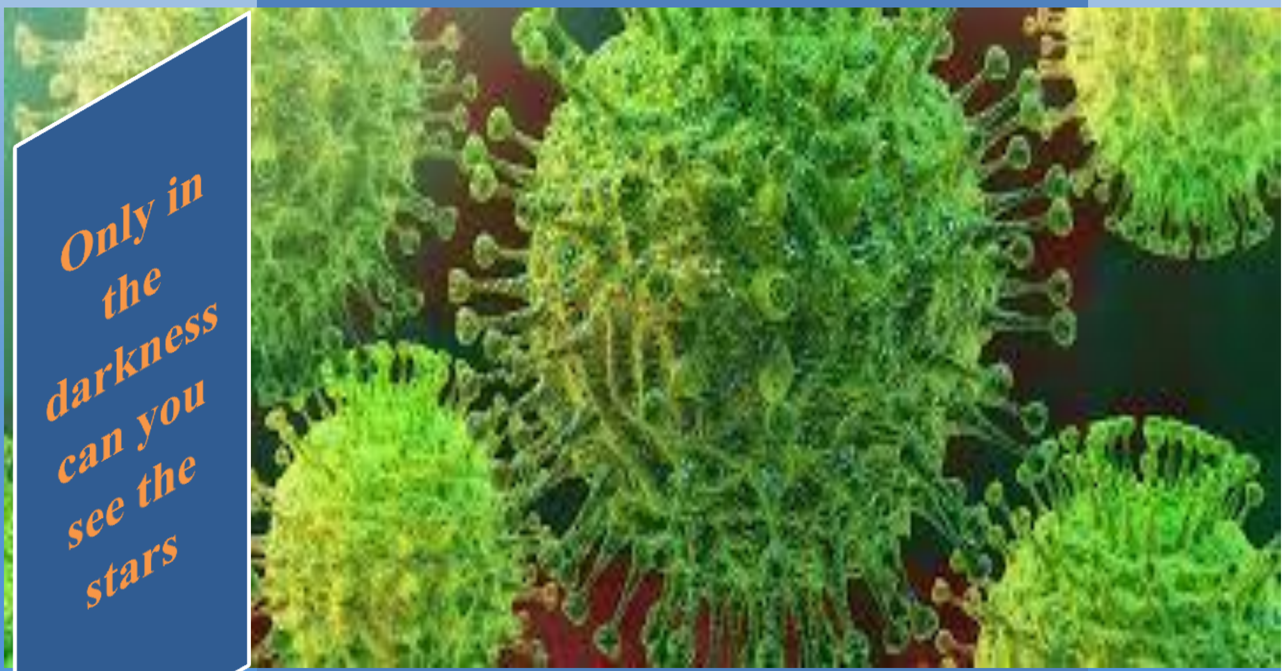
CHAPTER I

METHODOLOGICAL APPROACH TO THE RESEARCH



Only in the darkness can you see the stars

Methodological Approach to the Research

1.1. Introduction

This section of the report briefly presents the methodological approach to this research report. A traditional/academic approach has not been followed here since this a report rather than an academic research activity. However, research objectives, research hypotheses, research design, data collection and analysis procedures and ethical considerations are explained under this section.

1.2. Objectives and scope of the study

The primary objective of this study is to investigate and assess the immediate economic impacts of the COVID-19 on Sri Lankan economy.

The procedures of data collection and analysis are entirely depending on the research objectives and thus core and specific objectives are given below.

Main objective

It is obvious that all the economies affected by the COVID-19 and the assessment of the impact of the pandemic that quantify the likely magnitudes of the effects must be evaluated within a range of scenarios for the formation of policy strategies for regaining the economies from the pandemic. Accordingly, the primary objective of this study is to investigate and assess the immediate economic impacts of the COVID-19 on Sri Lankan economy.

Specific objectives

The COVID-19 outbreak has an unprecedented effect on the entire economic activities in Sri Lanka. As a result of the temporary decline of household consumption, a sharp but impermanent decline in domestic consumption and investment can be observed. The outbreak affected directly on future business activities, including collapse of tourism and business travel; spill overs of weaker demand on other sectors and economies through trade and production linkages, supply side disruptions to production and trade and effects on healthcare spending. Further, the Government of Sri Lanka has provided relief packages that include allowances to low income and vulnerable families as well as individuals, suspension of lease and debt moratorium, extension on utility bill payments. The following specific objectives have been established by considering all these aspects,

- to investigate the COVID-19 impact on various economic activities in Sri Lankan households
- to investigate the COVID-19 impact on selected major economic sectors in the Sri Lankan economy
- to suggest appropriate policy measures and a plan of action for regaining Sri Lankan economy in the post-COVID-19 time horizon

Therefore, the study aimed at investigating the economic impacts of the COVID-19 amalgamating both quantitative and qualitative approaches to achieve the objectives of the study. Despite uncertainty surrounding some of this study's estimates and analysis, they are useful for policymakers to better understand the impacts of the COVID-19 outbreak for socio-economic development and performance, allowing them to plan ahead and identify devise strategies for more resilience to the COVID-19 impacts on the economy.

Both quantitative and qualitative approaches were employed to achieve the objectives of the study.

1.3. Research hypothesis

1. The COVID-19 pandemic has created many negative effects on diverse economic activities in Sri Lankan households.
2. The COVID-19 pandemic adversely affected the many facets of the Sri Lankan economy.

1.4. Research design

Methodological approach

The research was designed amalgamating both inductive and deductive approaches in order to suit the research objectives. Deductive approach is used to describe a method of reasoning where conclusions are deduced logically from other things that are already known. A deductive approach to research is the one that researchers typically associate with scientific investigation. The researcher studies what others have done, reads existing theories of whatever phenomenon it is studying, and then tests hypotheses that emerge from those theories. A deductive approach allows to test the relationships or links on more general circumstances (Bernard, 2011).

Inductive reasoning starts with the observations and theories that are proposed towards the end of the research process as a result of observations (Goddard & Melville, 2004). Inductive research "involves the search for pattern from observation and the development of explanations – theories – for those patterns through series of hypotheses" (Bernard, 2011). No theories or hypotheses would apply in inductive studies at the beginning of the research and the researcher is free in terms of altering the direction for the study after the research process has commenced.

Philosophical approach

Ontological view

Philosophically, ontology is a doctrine of the objective reality on the whole. But it is only one definition; the second one treats ontology as a theoretical construct of the explored reality. These interpretations are equally important for analysis of ontology and ontological problems in any science. In economics, these two interpretations are also applied. Economic ontology is a notion of the part (or aspect) of reality, analysis by economists, or a notion designating the economic view on the reality. There are two positions that are referred to as objectivism and constructionism respectively (Bryman & Bell, 2007). Objectivism exists whether human beings are there to observe it or not. On the other hand, there is a real world "out there" which exists independently of our senses. In this research, the ontological consideration is objectivism.

Economic ontology is a notion of the part (or aspect) of reality, analysis by economists, or a notion designating the economic view on the reality.

Epistemological view

Social sciences - and within them economics and management and organizational sciences in particular - are living a great and renewed interest for its epistemological and methodological statutes, as witnessed by many books and specialized journals which flourished during the last two decades (Lucio, Biggiero et al., 2016). Epistemology in a business research, as a branch of philosophy, deals with the sources of knowledge. Specifically, epistemology is concerned with possibilities, nature, sources and limitations of knowledge in the field of study. Alternatively, epistemology can be branded as the study of the criteria by which the researcher classifies what does and does not constitute knowledge (Goddard & Melville, 2004). According to Bryman & Bell (2007), there are two positions mentioned as positivism and interpretivism respectively. It is common in the quantitative research design that the researcher tries to be neutral to the objectives of the study. The positivism paradigm is employed for the current study in order to resolve the research problems as guided by the kind of data and information available for the research.

Research strategy

According to Saunders et al. (2009), research strategy is always related to the ontology and epistemology of the study, and it takes into account the purposes of the research, the access of data and the restraints that may affect the process of the research. Quantitative research and qualitative research can be construed as different research strategies, which represent a useful means of classifying different methods of social science research. In this study, the deductive approach was primarily employed as quantitative data were used extensively to achieve the research objectives. In quantitative data analysis it was expected to turn raw numbers into meaningful data through the application of rational and critical thinking. Quantitative data analysis also includes the calculation of frequencies of variables and the differences between variables.

One of the objectives of this research was to obtain the views of practitioners of diverse sectors of the economy. In such case the quantitative strategy alone would not have been beneficial to the researchers to accommodate the third party's views of the COVID-19 impact on different sectors of the economy and thus some qualitative strategies were also employed. Content and Narrative Analysis were employed in the context of qualitative data analysis.

Since this research was a rapid assessment of the COVID-19 impact and the entire country was in 'locked down' while the research was conducted, the online questionnaire method and in-depth interviews by means of telephone interviews were conducted.

1.5. Data collection procedures

The impact of the COVID-19 has strongly affected every part of the economy and thus, all dimensions of the economy must be studied to understand the effect of the COVID-19. Therefore, both primary and secondary data were collected for this research to provide a meaningful conclusion. Since this research was a rapid assessment of the COVID-19 impact and the entire country was locked down during the research period, the online questionnaire method and in-depth interviews by means of telephone interviews were conducted for gathering of the relevant primary data. A Google form was created on the Google free platform for questionnaire surveys.

Forty-three questions were included in the questionnaire and it was administered online. The questionnaire was distributed using email addresses that were collected by the research team using different sources and public relations. A sample of 1500 households was chosen and finally 1087 usable responses were received covering 22 administrative districts in Sri Lanka. The reference period for the data collection was from 20th April 2020 to 20th May 2020.

The experts and practitioners in different sectors of the economy were interviewed by the research team and their views were accommodated for the analysis in terms of narrative analysis. Standard guidelines were adopted for interviews.

The experts and practitioners in different sectors of the economy were interviewed by the research team and their views were accommodated for the analysis.

A discussion of the impact of the pandemic must be comparative and hence researchers were encouraged to use the secondary data sources as well. The Central Bank of Sri Lanka, the Tourism Development Board, the Chamber of Commerce and available online reports were the secondary data sources utilized.

1.6 Results and discussions

All responses were analysed using different kinds of charts and graphs with supportive frequency tables. Most of the findings were illustrated in pictorial form for better understanding of the wide-ranging audience.

1.7 Ethical considerations

Ethical consideration is one of the important parts of a research. Research ethics are generally known as the set of ethics that govern how scientific and other research is performed at research institutions such as universities, and how it is disseminated (Resnick, 2015). At the core, these ethical principles points out the need to (a) do good (b) do no harm. In practice, a researcher needs to (a) obtain informed consent from potential research participants; (b) minimize the risk of harm to participants; (c) protect their anonymity and confidentiality; (d) avoid using deceptive practices; and (e) give participants the right to withdraw from his/her research. All these ethical considerations were practised honestly within the research process since this research study was entirely on human attitude and their behaviour.

1.8 Chapter summary

This chapter briefly provided the methodology adopted for the research. The main objective of the research was to investigate the COVID-19 impact on the Sri Lankan economy as a whole and on individual households. Philosophically, the ontological consideration is objectivism and the positivism paradigm was employed for the current study in order to resolve the research problems as guided by the kind of data and information available for the research. The use of the quantitative strategy would not benefit the researchers to accommodate the third party's views of the COVID-19 impact on different sectors of the economy and thus some qualitative strategies were also employed. Content and narrative analysis were employed in the context of qualitative data analysis. Primary and secondary data were employed for the analysis and ethical considerations, which totally adhered to the process of data collection.

Philosophically, the ontological consideration is objectivism and the positivism paradigm was employed for the current study in order to resolve the research problems.

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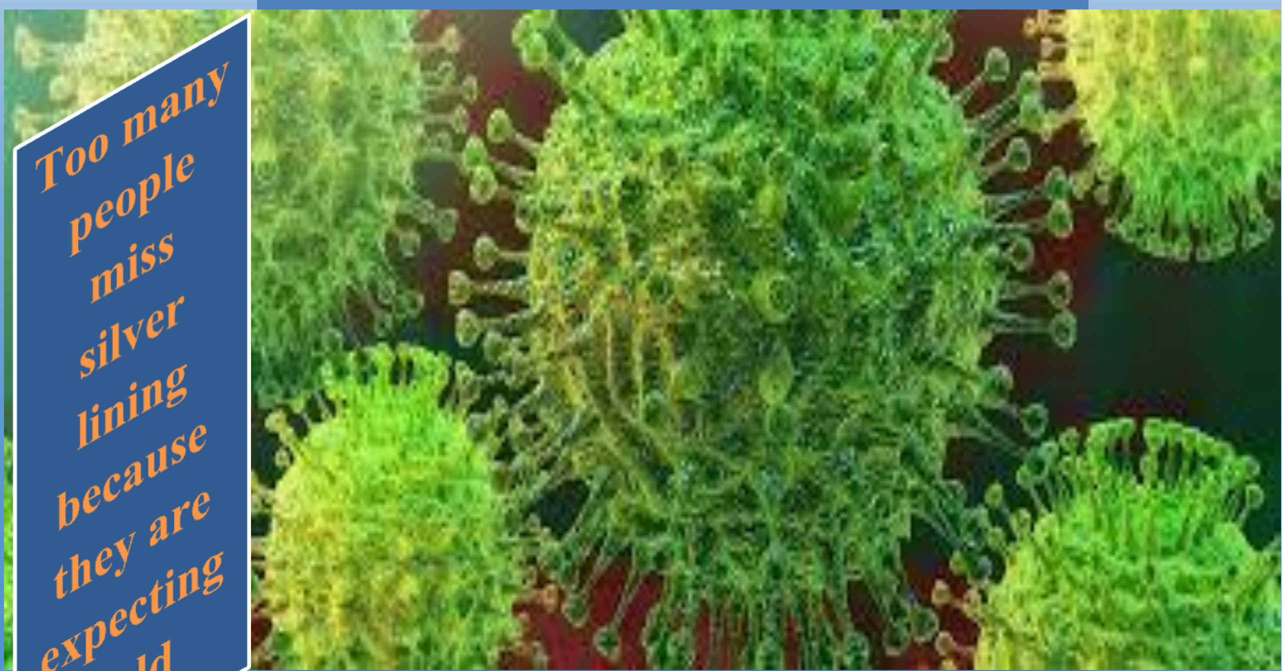
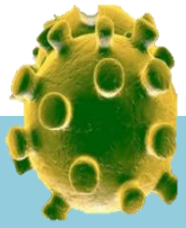
CHAPTER II

THE ECONOMIC BACKGROUND OF SRI LANKA BEFORE THE COVID-19 PANDEMIC



Too many people miss silver lining because they are expecting gold



The Economic Background of Sri Lanka before the COVID-19 Pandemic

2.1. Introduction

This chapter provides the reader with the salient features of the Sri Lankan economy before the COVID-19 pandemic. It covers major economic activities and their performance in the recent past.

2.2. Sri Lanka at a glance

Sri Lanka has recorded 1.6 per cent of negative economic growth rate for the first Quarter of 2020.

Sri Lanka was downgraded to a lower-middle-income group in July 2020 under the World Bank new country classification.

The island of Sri Lanka (the Democratic Socialist Republic of Sri Lanka), is located 54 km off South India and between the Far and Near East, adjacent to one of the world's busiest shipping routes. The country has a tropical climate and occupies an area of 65,610 square kilometres, including inland water resources. The geographical shaping of the country helps the alternative power generations such as solar, hydro and wind. Sri Lanka upgraded to the upper middle income country status as per the World Bank classification of countries published in July 2019 and within a short period of time it was downgraded to a lower-middle-income group in July 2020 under the World Bank new country classification (World Bank, 2020). Sri Lankan inhabitants (22 million) have achieved substantial gains in reaching several of the Millennium Development Goals [MDGs]. For example, at the end of the study period, the island has achieved a high literacy rate (92.5% at age of 5 years and above) and educational level, good longevity (72 years for male and 78.6 years for female), and a low rate of population growth (1.1%). Although government health expenditures as a percentage of GDP for Sri Lanka was relatively low (in 2019, 1.6% of the Gross Domestic Product (GDP), health indicators in the country are the best among other nations in South Asia and quite good from an international perspective . By the end of 2018, the Human Development Index (HDI) of the country stood at 0.780 and rank at 71 among 189 countries. The Overall Poverty Headcount Ratio (PHCR) was relatively low (4.1%) (CBSL, 2019). By contrast to these positive trends of some indicators, however, it can be estimated that approximately 23% of the population face income or consumption poverty, since 33% of Sri Lankan households are receiving *Samurdhi* benefits.

As regards the socio-demographic pattern of the society, the ethnic composition indicates that 74% of the total population in Sri Lanka is Sinhalese, 15% Tamil and 9% Moors and Malays. Sector-wise, 77.4% of the population lives in rural areas, 18.2% in urban and rest of 4.4% in the Estate sector (CBSL, 2019). The major religions are Buddhism (70%), Hinduism (13%), Islam (9%), and Christianity (7%). The Thirteenth amendment to the Constitution was introduced in 1987. It stated that, "the official language of Sri Lanka is Sinhala" while "Tamil shall also be an official language," with English as a "link language". Most official government functions are carried out in three languages, while Sri Lankan airline is probably the only international carrier that uses Tamil as one of its languages. In Parliament, legislators may make speeches in Sinhalese, Tamil or English.

From the economic perspective, the growth pattern of independence in Sri Lanka consists of five major economic booms together with four trough of recessions.

2.3 The five major economic booms

From the economic perspective, the growth pattern of independence in Sri Lanka consists of five major economic booms together with four trough of recessions. The First economic boom was in the period between 1965 and 1968. Among others two factors: boom in production (agriculture, manufacturing and construction) and increase of domestic consumption largely contributed to this favourable trend. It followed by a trough in 1971 as the result of the *Janatha Vimukthi Peramuna* (JVP) insurrection and decline in the performance of domestic agriculture and construction sectors.

The second economic boom was marked in 1977-1978. It is called the post-liberalization boom and followed by a trough of recession in 1987 which resulted in a single factor that was the second wave of the JVP insurrection. The third economic boom in the business cycle in Sri Lanka marked in 1990 as a result of initiating the second wave of liberalization. The single-most important constraint to economic growth in the last two decades of 20th century was armed conflict which continued since 1983. As estimated by the Central Bank of Sri Lanka, the conflict has reduced economic growth by two to three per cent and has diverted public resources away from economic reform. Despite the brutal civil war since 1983, the economic growth of the next two decades has averaged around 4.5%. In 2001, however, GDP growth was negative (-2%). (The only contraction since independence). Global recession, slowdown in agriculture and hydropower generation and high domestic food price due to drought and terrorist attacks are the contributing factors to the economic recession in 2001. However, regaining the pre-economic situation, a 4.0% growth rate was recorded in 2002.

In the fourth boom, the economy grew more rapidly after 2002 due to the Norwegian-mediated Ceasefire Agreement between the Government of Sri Lanka (GoSL) and the Liberation Tigers of Tamil Elam (LTTE) and subsequent economic reforms (2002-2006), recording a growth rate of 6.0% in 2003 and 5.4% in 2004. The economic situation in Sri Lanka in 2006 was stable, despite the two cautious external shocks: resumption of hostilities between the government and the LTTE and escalating oil and food prices in the world market. The GDP growth in 2006 remained strong at 7.4%. The GDP grew in the first half of 2007 at an annual rate of 6.2%. The per capita income in 2006 was also high at USD 1,355. The figure was the highest in South Asia after the Maldives (MHHDC, 2007). The economy again reached a trough of recession in 2009 due to a number of reasons such as higher military expenditure and drawback in agriculture due to adverse weather conditions.

Finally, the post-conflict (between the GoSL and LTTE) boom marked 2010-2012. Sri Lanka is continually experiencing an economic recession since 2013 as a result of external shocks such as negative growth of agriculture due to prolonged drought, rapid capital flight responding to tight global financial conditions and sharp depreciation of the Sri Lankan Rupee, slowdown in industrial activities, the Easter Sunday attacks in 2019 and weak growth of credit to the private sector in 2019 (CBSL 2019). According to the MTI Business Review of 2019 and Outlook for 2020, over 50% of the surveyed CEOs and business leaders from Sri Lanka predicted the economy would stabilize in the year 2020. With fairly favourable predictions from the global arena, Sri Lankan industries and service providers have also expressed optimism for the year 2020.

According to the MTI Business Review of 2019 and Outlook for 2020, over 50% of the surveyed CEOs and business leaders from Sri Lanka predicted the economy would stabilize in the year 2020.

2.4 Industry and the service sector performance

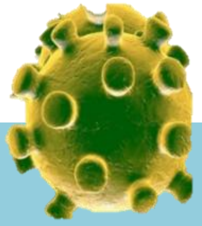
The service-sector is the largest component contributing at around 57% to the country's GDP. In the recent past, the services-sector continued its strong expansion, fuelled primarily by strong growth of the sectors of insurance and financial services (7.5%), telecommunication (6.4%), transport (6.3%) and trading (4.7%). Public administration and defence expenditures increased due to resumption of hostilities, expansion of public sector employment including the Minister of Cabinet (9.6%). There is also a growing trend of information technology (IT) sector (4.7%), especially information technology training and software development (4.7%) (Department of Census and Statistics, 2019).

However, the Easter Sunday attacks adversely affected on the services sector activities slowed down to 2.3% in value added terms in 2019, recording the lowest growth in nearly five years, down from 4.6% in 2018. The impact of the attacks mainly extended to tourism related services, including accommodation, transportation, wholesale and retail trade activities, and other personal services. Meanwhile, financial services, real estate, public administration, telecommunications, insurance, education, professional services, human health and IT programming consultancy and related services expanded during the year (CBSL 2019).

On annual average basis, the industrial sector accounted for 27.5% of the GDP for the period from 2010 to 2018. Sub-sector-wise, manufacturing was the largest contributor, accounting for 17.5% of the total industrial output. Within the sector, food, beverages, and tobacco contributes the largest share (6.6%) and followed by textile, apparel, and leather products sub-category by 4.9% for period. The construction sector accounts for 6.7% of the GDP while the mining and quarrying accounts for 2.4% of the GDP.

The industrial production of the manufacturing sector for the fourth quarter of 2019 has increased by 0.7 % compared to the same quarter in 2018. Among the manufacturing industries; volume of products of 'Manufacture of chemicals & chemical products' has shown a remarkable increase (22.5%) in production during the fourth quarter of 2019, compared to fourth quarter in 2018 and volume of products of 'Tobacco products' (17.5%), which reported a

The industrial production of the manufacturing sector for the fourth quarter of 2019 has increased by 0.7 % compared to the same quarter in 2018.



decrease during this period (Department of Census and Statistics, 2019).

Agriculture has lost its relative importance in the Sri Lankan economy in recent decades. Although the sector has been employing just about 33% of the working population, it contributes to only about 8% of the GDP. Rice, the staple cereal, is cultivated extensively in the subsistence agricultural sector. The plantation sector consists of tea, rubber, and coconut. In recent years, the tea crop has made significant contributions to export earnings (CBSL, 2019).

The unemployed population reported in 2019 is 411,318. Survey reports that unemployment rates for male and female are 3.3% and 7.4%, respectively. Among all age groups, unemployment rates of females are higher than those of males. Youth unemployment (age 15 – 24 years) rates are the highest for both sexes, compared to other age groups. When level of education is considered the highest unemployment rate (8.5%) reported from the G.C.E. (A/L) & above group. It is 5.0% and 11.9% for male and female respectively. Gender-wise, female unemployment rates are higher than those of male as well as country percentages (Department of Census and Statistics, 2019).

Sri Lanka has comparatively a well-developed financial system, even better than other countries in the region. The formal financial system in Sri Lanka consists of the five categories of financial institutions.

Sri Lanka has comparatively a well-developed financial system, even better than other countries in the region. The formal financial system in Sri Lanka consists of the five categories of financial institutions regulated by the Central Bank of Sri Lanka. These include banking institutions, deposit institutions, long-term lending institutions, contractual savings institutions and other specialized finance institutions.

At the end of 2019, the banking institutions comprise the Central Bank itself, 26 Licensed Commercial Banks (consisting of 2 state banks, 11 domestic private banks, and 13 foreign banks) and 6 Specialized Banking Institutions (including savings and development banks and regional development banks).

Deposit Institutions include the National Savings Banks while the Long-term Lending Institutions comprising a number of specialized developments finance institutions such as the National Development Bank, the Development Finance Corporation of Ceylon Bank, and the State Mortgage Bank. Contractual savings institutions are the

Insurance Companies and Social Security Funds (Employee Provident Fund and Employee Trust Fund). The other specialized financial institutions comprise the Leasing Companies, Merchant Banks, Venture Capital Companies, and Finance Companies.

In addition to these formal financial institutions, there is a widespread network of semi-financial institutions within the cooperative sector. These are not regulated or supervised by the CBSL. These include the Cooperative Rural Banks (CRBs), and the Thrift and Credit Cooperative Societies (TCCSs). Apart from these cooperatives, a number of Savings and Credit Unions such as *Samurdhi* Banking Societies (SBSs) and Non-Government Organization companies such as the *Sarvodaya* Economic Enterprise Development Services (SEEDS) are operating nationwide specializing microfinance to the rural poor. These Rural Savings and Credit Unions together with structured Financial Cooperatives complement the regulated banking system.

Since 1990, considerable de-regulation of the banking system in the country has been adopted under a series of reforms sponsored by the World Bank and the International Monetary Fund (IMF). With these reforms, heavy involvement of Central Bank in refinancing the loans advanced by the commercial banks to priority sectors in the past has been withdrawn, but a new series of reforms has been adopted for strengthening the regulation and supervision of banks, and bringing banking supervision into line with international practices. Areas that have been strengthened under the reforms include classification and provision of non-performing loans and advances, capital adequacy requirements, and accounting and auditing standards. Most exchange controls have also been removed.

Sri Lanka shifted away from the socialist-orientated inward-looking economic policies to the package of export-oriented outward-looking policies and opened its economy to free foreign trade and investment flows.

2.5 Changing of the development policies

From the perspective of development policies, in 1977, Sri Lanka shifted away from the socialist-orientated inward-looking economic policies to the package of export-oriented outward-looking policies and opened its economy to free foreign trade and investment flows. But the pace of reform has been uneven. For example, as observed by the Government of Sri Lanka and the Millennium Challenge Corporation (2017: p12):

> *"Sri Lanka's income inequality is severe, with striking differences between rural and urban areas. About a quarter of the country's total population remains impoverished. Civil conflict, falling agricultural labour productivity, lack of income-earning opportunities for the rural population, and poor infrastructure outside the Western Province are impediments to poverty reduction".*

Meanwhile, the declining trend in inflation observed for the period from 2012 (7.54%) to 2015 (2.24%), reversed, starting in 2015 and continued upto 2017 (6.58%). The inflation rate was 4.1% for 2019. Most recent figures, for example, show a trend of declining inflation and budget deficits (-5.5%) that resulted to macro-economic stability in the economy. However, the budget deficit is equal to -6.8% of the country's gross domestic products in 2019. In 2019, growth of the money supply accelerated and broad money expanded, reflecting credit expansion (mainly to the government). The government debt estimated as 86.8% of the GDP in December 2019. The weighted prime lending rate fell from 12.2% in April to 9.2 in December in 2019.

Most recent figures, for example, show a trend of declining inflation and budget deficits (-5.5%) that resulted to macro-economic stability in the economy.

Irrespective of the above trends, when compared to the East Asian Newly Industrial Countries (Asian Tigers), the economic growth in Sri Lanka is, however, relatively slow. Such a slow growth rate has been attributed to two factors: the ethnic conflict that erupted in 1983 and the substantial involvement of the government in the economy.

Although the private sector appears to be growing with the economic liberalization policies adopted since 1977, the State is still heavily present in several key sectors including power, transport, banking, agricultural input, and labour. For example, 14% of the labour force is being employed by the government, representing almost half of the formal employment in the economy.

In turning to the foreign trade sector, the exports consist of textiles (51% by value); tea (14%); other agricultural products (6%); machinery, mechanical and electrical equipment (6%); latex products (4%); and diamonds and jewellery (4%). It reflects the fact that Sri Lanka's exports sector is largely concentrated on two primary products: garments and tea. Garment exports face increased competition after the 2005 expiration of the worldwide Multi-fibre Arrangement. The tea industry was challenged by a shortage of plantation labour and by growing competition. In 2019, Sri Lanka recorded a total value of USD 16.4 billion of exports. Main categories of exports are apparel, tea rubber, gems and jewellery.

In the services sector, the tourism industry of Sri Lanka closed in 2019 with total revenue of USD 3.6 billion. According to the Central Bank of Sri Lanka, revenue from tourism slipped by 18% following the Easter Sunday attack[s] and the tourist arrival was at 1.9 million last year, against the 2.3 million arrivals and the USD 4.4 billion revenue recorded last year. Sri Lanka's ICT, BPM and Telecommunications service sectors also recorded estimated export revenue just above USD 1 billion while also recording a workforce growth of 50% since 2014.

In 2019, Sri Lanka recorded a total value of USD 19.9 billion of imports (mainly fuel 19%, textiles 14%, food 7%, machinery 12% and vehicles 5%). The resulting large trade deficit was financed primarily by foreign assistance, commercial borrowing, and by remittances from Sri Lankan expatriate workers. In total, temporary migrants are estimated to number 1.9 million: almost 23% of the labour force.

A majority are women working as housemaids and are an important source of foreign exchange for Sri Lanka, well ahead of apparel (USD 5 billion), tourism (USD 4.4 billion) and agricultural exports (USD 2.7 billion of which tea was USD 1.5billion). The net inflow of foreign private remittances by 1.2 million Sri Lankan residing abroad amounts currently to 7.9% of the GDP, and is important in balancing the net trade and payments deficits. The workers' remittances recorded a decline of 4.3 %, amounting to 6.7 billion USD in 2019 compared to 7 billion USD in 2018.

Obviously, Sri Lanka depends on a continued strong global economy for investment and for expansion of its export base. The government plans an ambitious infrastructure development programme to boost growth. It hopes to diversify export products and destinations to make use of the Indo-Lanka and Pakistan-Sri Lanka Free Trade Agreements, the General System of Preference GSP+), treatment by the European Union (EU) and other regional and bilateral Preferential Trading Agreements.

Sri Lanka's most important exports market is the United States. It was estimated to be around USD 2.1 billion in 2017, or 25% of total exports. For many years, the United States has been Sri Lanka's

Large trade deficit was financed primarily by foreign assistance, commercial borrowing, and by remittances from Sri Lankan expatriate workers.

biggest market for garments, taking almost 60% of the total garment exports. The top import origins are India (USD 4.5 billion), China (USD 4.2 billion), Singapore (USD1.3 billion), the United Arab Emirates (USD 1.6 billion) and Japan (USD 1.02 billion). India is Sri Lanka's largest supplier, accounting for 22% of imports valued at over USD 4 billion. United States exports to Sri Lanka are estimated to be around USD 813.6 million in 2017, consisting primarily of textiles and specialized fabrics, tobacco, newsprint, food and beverages, chemicals, synthetic rubber-primary, electrical apparatus, telecommunications equipment, computers and accessories, and industrial supplies (United Nations, 2019).

2.6 The progress of foreign policy and foreign aid

Sri Lanka traditionally followed a non-aligned foreign policy. The island was a founding member of the Non-Aligned Movement (NAM, but has been seeking closer relations with the United States, China and India.

From the foreign policy point of view, Sri Lanka traditionally followed a non-aligned foreign policy. Sri Lanka was a founding member of the Non-Aligned Movement (NAM), but has been seeking closer relations with the United States since December 2001 to 2006 and with China and India since 2006. It participates in multilateral diplomacy, particularly at the United Nations, where it seeks to promote sovereignty, independence, and development in the developing World. It also is a member of the Commonwealth, the South Asian Association for Regional Cooperation (SAARC), the World Bank, the International Monetary Fund, the Asian Development Bank, and the Colombo Plan. Sri Lanka continues its active participation in the NAM, while also stressing the importance it places on regionalism by playing an active role in the SAARC.

Sri Lanka is heavily dependent on foreign assistance, with the World Bank, the Asian Development Bank, Japan, and other donors disbursing loans amounting USD 912 million in 2006. Foreign grants amounted to USD 301 million in 2006. While implementation of aid projects has been spotty over the years, the government is trying to improve this record by streamlining tender processes and increasing project management skills. The Asian Development Bank (ADB), the World Bank (WB), Japan and the United Nations Development Programme (UNDP) are the largest donors of aid to the country. The United States Agency for International Development (USAID) is the lead donor working on competitiveness at the industry cluster level and developing policy reform through the private sector (United Nations, 2019).

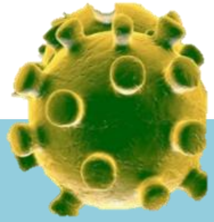
Major donors supporting key infrastructure improvements are Japan, the World Bank (WB) and the Asian Development Bank (ADB). The government of Sri Lanka receives funding from the WB and ADB for macro-economic reforms, including privatization of the plantation industries and telecommunications. In the area of legal and judicial reform, a WB loan will improve court infrastructure, administration and commercial law reforms. USAID humanitarian activities complement efforts of UN agencies such as the UNICEF the World Health Organization (WHO), The United Nations High Commissioner for Refugees (UNHCR) and international voluntary organizations, which are provided health care and shelter to the displaced.

According to the ADB’s Country Operations Business Plan (COBP) for the years 2020 - 22, the proposed lending program for Sri Lanka for the 3-year period is estimated at USD 2.46 billion. The programme is expected to focus heavily on the development of transport infrastructure.

From the policy-making point of view, the government has recently [2007] published a paper, "Creating Our Future, Building Our Nation". The paper suggests a less interventionist role of the government and includes a focus on reducing poverty through rural economic development, promoting small and medium enterprise, restructuring state-owned enterprises, having a smaller budget deficit, and promoting better civil services.

It is believed that the future of Sri Lanka's economic health, however, primarily depends on political stability, return to peace, and continued policy reforms--particularly in the area of fiscal discipline and budget management. Rising oil costs and the 24-year conflict have contributed to Sri Lanka's heavy public debt load (90% of GDP in 2007). Sri Lanka needs economic growth rates of 7% to 8% and investment levels of about 30% of GDP for a sustainable reduction in unemployment and poverty. In the past 10 years, investment levels have averaged around 25% of GDP. Domestic investment seen in areas like tourism and information and communications technology (ICT) will need to be complemented by increased foreign investment, as well as increased private investment in export sectors.

> It is believed that the future of Sri Lanka's economic health primarily depends on political stability, return to peace, and continued policy reforms in the area of fiscal discipline and budget management.



2.7 Sri Lanka just before the COVID-19

According to a Central Bank report issued on April 29, 2019, Sri Lanka's foreign debt is more than USD 55 billion. Global ratings agencies such as Fitch and Moody's have delivered dire warnings: Moody's cited capital outflows, the devaluation of the rupee and low reserves in the face of large external debt service payments. It said the country has "very weak debt affordability." It is expected "Sri Lanka's debt burden to rise to nearly 100% of GDP (gross domestic product)" (Gunadasa, 2020).

Morgan Stanley, a global investment bank, rated the sovereign bonds of crisis-ridden Pakistan and Ghana as better than Sri Lanka's, making it more challenging for government borrowings. Similarly, on April 24, Fitch Ratings downgraded Sri Lanka's sovereign rating from B to B-, predicting the "economic shock from the COVID-19 would further erode rising public and external debt sustainability." Analysts warned that the printing of more money by the Central Bank could further downgrade the index (Gunadasa, 2020).

The economic situation of Sri Lanka before the COVID-19 was not healthier and vulnerable to the external shocks and are in the recession era.

Fitch added that it was difficult for Sri Lanka to raise funds from international financial markets to repay debt and the country had to look for alternative sources. This difficulty was evident recently. When the country offered USD 60 million worth of bonds last week, only USD 28 million was raised. In the remaining months of this year, the government will have to pay USD 3.2 billion for loans and interest, followed by USD 13.8 billion for debt service from 2021 to 2023.

Sri Lanka's economic freedom score is 57.4, making its economy the 112th freest in the 2020 index. Its overall score has increased by 1.0 point due to a higher fiscal health score. However, its overall score is well below the regional (61.1) and World averages (61.6). (https://www.heritage.org/index).

Sri Lanka ranks 93rd out of 180 countries on the Corruption Perceptions Index (CPI) which was launched by Transparency International Sri Lanka in June, 2019. The Latest data shows a score of 38 not changed since 2017. Sri Lanka has changed its rank from 89 in 2018 to 93 last year. Campaign financing regulations could help to increase Sri Lanka's rank.

It is clear that the economic situation of Sri Lanka before the COVID-19 was not healthier and vulnerable to the external shocks and are in the recession era. It was demanding a wider range of reforms on the economy to take it in to the sustainable growth path. In this effort, policy makers should pay attention to internal stability through strengthening fiscal consolidation, improve tax collection efforts and adopt prudent monetary and exchange rate policies, rationalize wasteful expenditure with precise targeting of poverty welfare programmes, promote sustainable agriculture and address persistent poverty in the rural sector, minimize corruption by promoting transparency and accountability, improve Doing Business indicators. Meanwhile, it is necessary to increase export earnings and FDI flows to achieve external stability and to manage high levels of debt to achieve macroeconomic balance. With this social, economic, political and environmental background in the country, investigation of the socio-economic impact of the COVID-19 is more important, from a policy point of view in the country.

2.8 Chapter summary

Sri Lanka is a lower-middle-income country with a GDP per capita of USD 4,030 (2019) as per the World Bank country classification released on 1st July 2020 (World Bank, 2020). Following the 30 years of the North-East civil war, the economy grew at an average 5.6 % during the period of 2010 - 2019, reflecting a peace dividend and policy thrust towards reconstruction and growth. Growth is estimated to have been 2.6 % in 2019, partly explained by the April Easter Sunday attack[s] and the political instability.

The Sri Lankan economy is transitioning from a predominantly rural agro-based economy towards a more urbanized market-oriented economy driven by manufacturing and services. The service sector is now dominating the economy while the agriculture sector is shrinking. Social indicators related to education and health rank among the highest in South Asia and are comparable even with developed countries. During the last two decades, the economic growth has translated into a downturn in the national poverty headcount ratio significantly declining from 15.3% in 2006/07 to 4.1% in 2016. Unemployment is a rural phenomenon and a relatively large portion of the rural population subsists on slightly more than the national poverty line. Low tax revenues combined with largely

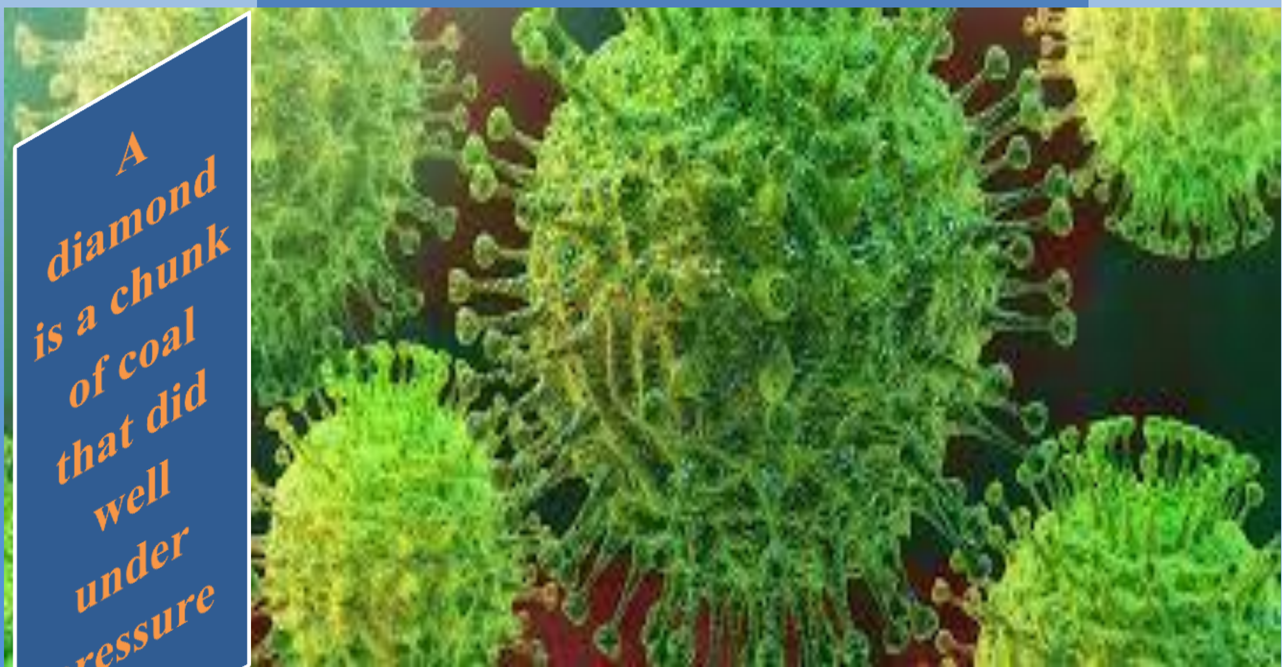
Sri Lanka is a lower-middle-income country with a GDP per capita of USD 4,030.

The Sri Lankan economy is transitioning from a predominantly rural agro-based economy towards a more urbanized market-oriented economy driven by manufacturing and services.

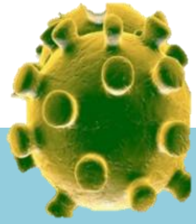
non-flexible recurrent expenditure in salary bills, household transfers, and interest payments of public debts have crowded out crucial development spending on health, education and social wellbeing. A public debt level exceeding 78% of the GDP is high while the realization of foreign direct investment is fairly weak.

CHAPTER III

The COVID-19 IMPACTS ON HOUSEHOLDS IN SRI LANKA WITH SPECIAL REFERENCE TO THE SOUTHERN PROVINCE



A diamond is a chunk of coal that did well under pressure



The COVID-19 Impacts on Households in Sri Lanka with Special Reference to the Southern Province

There were 1884 confirmed COVID-19 affected cases and 621 active cases in hospitals with 11 deaths while 1252 recovered and discharged from hospitals as of 14th June 2020 in Sri Lanka

3.1 Introduction

It has witnessed that more than 200 countries in the world have already been affected by the COVID-19 pandemic directly and indirectly. The outbreak of the COVID-19 severely affected Asian countries and Sri Lanka is no exception, since the economic activities of the country are interrelated with global economy through international trade. The impact of the pandemic was blew through the whole economy just before and after the lockdown of the country. The ongoing health pandemic severely affected economic conditions of different layers of the household economy. This was further worsening the livelihood of individuals and families in the country due to initiated government restrictions and regulations such as social distancing. This section of the report investigate issues related to household economic activities due to the COVID-19 pandemic.

It is apparent that direct health impacts are substantially low on households in Sri Lanka, with compared to other regions of the world. There were 2770 confirmed cases, 653 active cases in hospitals with 11 deaths while 2106 recovered and discharged from hospitals as of 26th July 2020 in Sri Lanka (Health Promotion Bureau, 2020). However, almost all the households were more or less economically affected after the imposing of the lockdown of the country with continued nationwide curfew regulations. Therefore, there is an urgent need to assess the economic impact of the COVID-19 on Sri Lankan households to mitigate the economic impacts of the crisis in terms of those well-off as to household conditions.

Accordingly, the Department of Economics of the University of Ruhuna, under the guidance of university authorities, conducted a rapid household survey. The survey was implemented between 20th

April 2020 and 20th May 2020. Statistics convert data into information and this section presents such analytical results of the household survey.

3.2 Analysis of the sample information

District-wise percentage distribution of households

This report is based on a sample of 1087 respondents covering 22 districts in the country. A structured questionnaire was administered to collect information online. A link of a google form was sent to the respondents through email addresses collected for this task. Figure 3.1 illustrates the percentage distribution of households throughout 22 districts in Sri Lanka. Therefore, the findings of this research can be generalized to the Sri Lankan society as a whole. By covering 22 districts of the country the survey has used a representative sample of households for the study. It is apparent that the survey has given more emphasis on the Southern Province since the share of households from the districts of Galle, Matara and Hambantota accounted for, 32% of the total households surveyed.

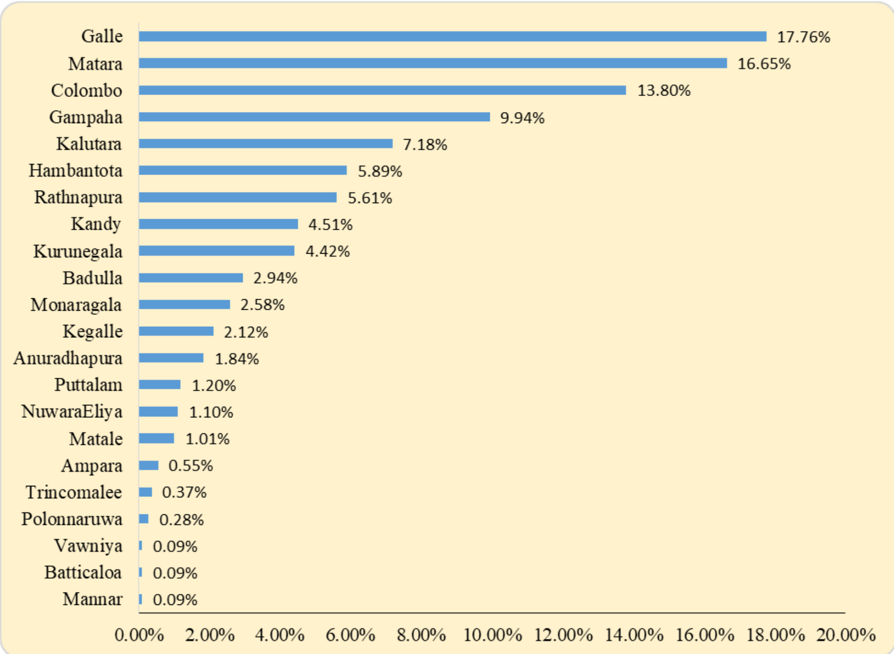


Figure 3.1: District-wise percentage distribution of households in the sample

The survey has given more emphasis on the Southern Province since the share of households from the districts of Galle, Matara and Hambantota accounted for, 32% of the total households surveyed.

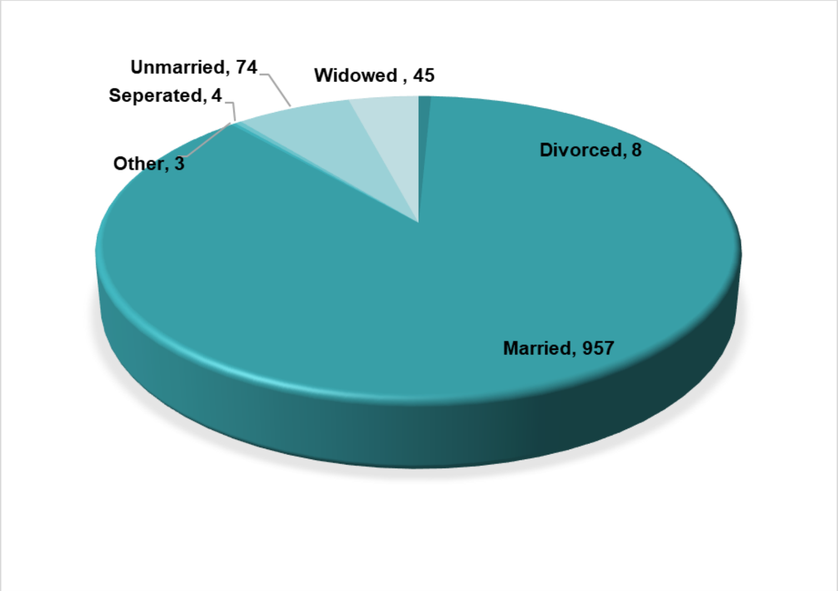


Figure 3.2: Civil status of the respondents

On average the respondents are 39 years of age with the standard deviation about 13 years

Individual characteristics of respondents are significant in social science research in expressing their ideas and views. Therefore, personal characteristics such as age, sex education of the sample have been examined.

Sample representativeness can be seen in several facets and the civil status of the head of the household is such a component. Figure 3.2 demonstrates the civil status of the sample and it is apparent that each and every relevant category has been accommodated in the sample of which nearly 88% of the respondents are married. It implies that this survey has been able to capture the economic changes in households well.

Age structure of the sample

In understanding of respondents' views about particular incidents, age structure plays an important role. The respondents' maturity is probably based even on their age and thus this research has examined the age distribution of the sample and it is illustrated in Figure 3.3. The majority of the respondents belongs to the age category pertaining to labour force participation. It is evident from the figure that on average the respondents are 39 years of age with the standard deviation about 13 years. Accordingly, young respondents have been involved in the sample and their views are significant for this kind of a research.

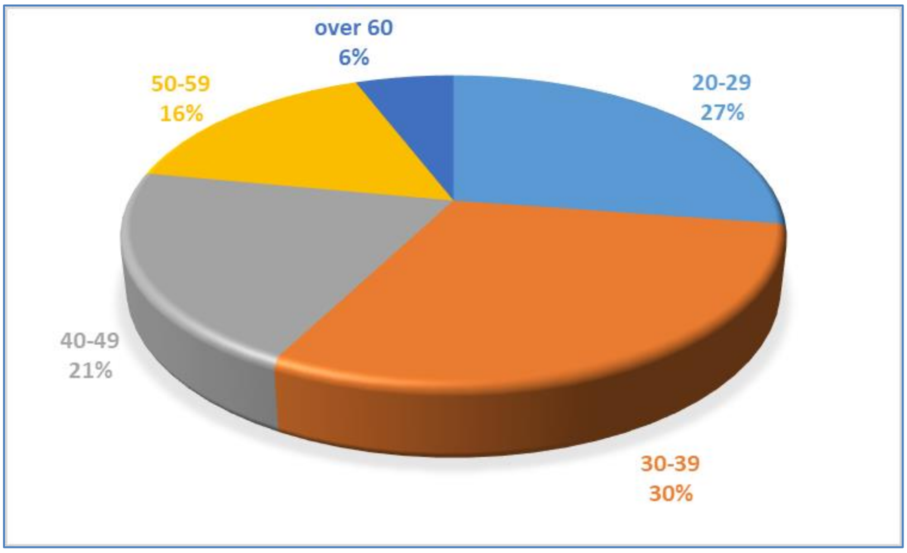


Figure 3.3: Composition of age-group structure of the sample

Gender distribution

The gender of the respondents in a social science research is also an important characteristic and facilitates to pursue different attitudes and different views on a social phenomenon. Therefore, the gender of the respondents has also been examined and Figure 3.4 presents the results.

It is apparent that the majority is male (85%) out of the total respondents investigated for the current study and the representation of females is approximately 15%. Households are customarily headed by males in Sri Lankan society while very few households are headed by females, and such cases are due to unavoidable circumstances. Therefore, the responded households are conventionally headed by males and their views will be strong enough to study the economic conditions of households.

Responded households are conventionally headed by males and their views will be strong enough to study the economic conditions of households.

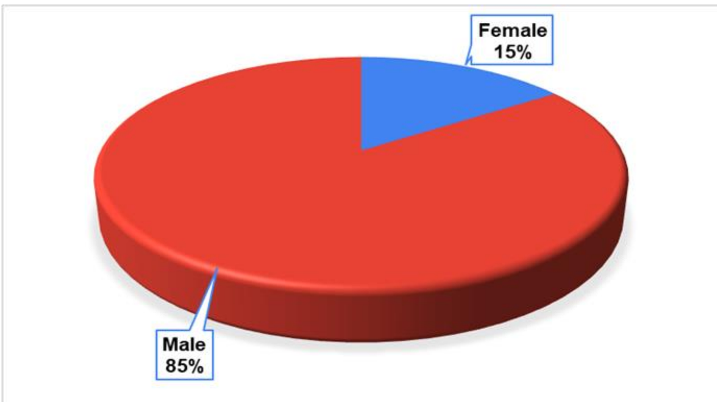


Figure 3.4: Gender distribution of the respondents.

Educational qualifications

Person’s attitudes, critical thinking and way of looking and understanding of social incidents possibly depend on the education level of the people of a given region or a country. Therefore, it is critical to know the educational background of the respondents in social science research. Thus, the variable “level of education of the respondent” was examined and results are illustrated in Table 3.1.

Table 3.1: Educational qualifications of the respondents

Qualification	Distribution of respondents	
	Count	Percentage
Postgraduate	245	22.54
First Degree	236	21.71
Certificate/Diploma	136	12.51
Tech/Voc. Training	76	6.99
Secondary	300	27.60
Primary	84	7.73
Other	06	0.55
No schooling	04	0.37
Total	1087	100.00

Source: Survey data

According to Table 3.1, more than 40% of the respondents were educated up to degree level and a relatively higher percentage (about 35%) were educated up to the higher secondary level. Approximately 25% of the respondents are in the category of vocational training and certificate or diploma holders. Since educated people are more likely to develop better moral and ethical values as compared to uneducated people, this research is privileged to have a higher percentage (above 50%) of educated people in the sample.

3.3 The COVID-19 impact on household activities

Due to the COVID-19 outbreak, the Government of Sri Lanka (GOSL) initially imposed lockdown regulations and declared four days of working from home and social distancing for the safety of Sri Lankans. It was unable to achieve the goals through this initial action and thus, the GOSL introduced an islandwide periodic curfew while a few areas, Colombo, Kalutara and Gampaha districts, were identified as red zones (high-risk areas). The high risk zones were imposed unspecified curfew for more than a month. The smooth-functioning of economic activities of the society and household activities were significantly interrupted due to the indefinite curfew in the high-risk areas and the intermittent curfew in the other areas. Therefore, the real indirect impact of the COVID-19 reached households and the current research is aimed at investigating the impact the crisis. This section of the report analyses the effects on household income, expenditure and savings in terms of monitory and non-monetary terms.

The smooth-functioning of economic activities of the society and household activities were significantly interrupted due to the indefinite curfew.

The effect of the COVID-19 on income level of households

A sharp vertical reduction in the wages of daily labourers due to the lockdown of the country was observed, and thus it was requested that the respondents report on how the household income has changed during the lockdown period. Figure 3.5 describes the changes on household income due to pandemic.

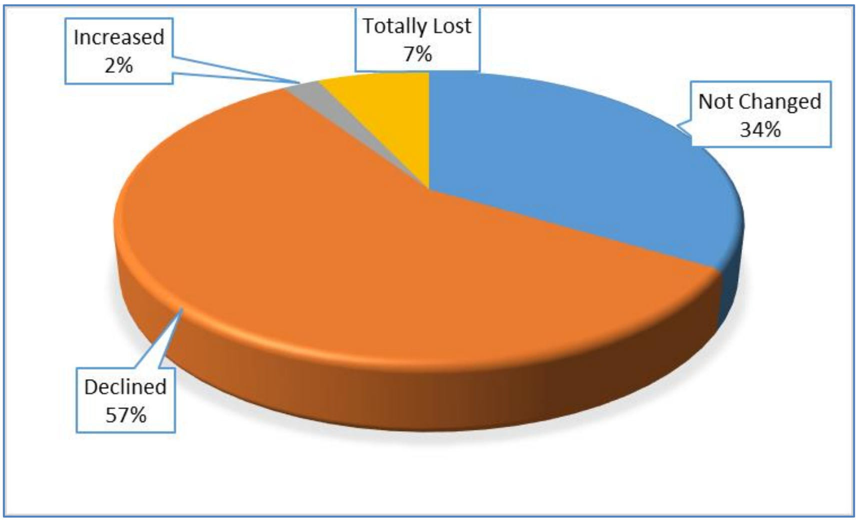


Figure 3.5: The COVID--19 impact on household income

The government continued paying the monthly salary of government employees during the lockdown period and hence government employees received their fixed income. Therefore, they were not harmed due to the COVID-19 outbreak. However, there is an entire loss of income for 7% of the respondents and these people may be largely working in the service sectors and are usually self-employed or informally employed in micro and family enterprises. They were the people who were in most danger during the lockdown period. The majority was able to survive through any means though the household income declined in some amount.

Entire loss of income for 7% of the respondents and these people may be largely working in the service sectors and are usually self-employed or informally employed in micro and family enterprises.

This research did not address the individual economic conditions but the household conditions. There may be a relationship between economic activities (job condition) and the household income. Table 3.2 illustrates the relationship between job status and the pattern of changing income of households. There is no association between these nominal variables (Cramer's V=0.08) and thus there is no relationship between the change in income and the change in job status after the COVID-19 outbreak. Therefore, the loss of household income will only be a temporary loss of their jobs and other income sources. Thus, the financial loss may be a temporary episode.

Table 3.2: Cross tabulation – Changes of income versus changes of job status after the COVID-19[1]

Change of income	Loss of job	On compulsory leave	No change	Working at home	Not doing a job	Received a new job	Total
Totally lost	3%	0%	1%	0%	2%	--	6%
Declined	4%	4%	20%	23%	6%	0%	57%
Not changed	0%	1%	17%	14%	2%	0%	34%
Improved	--	0%	1%	1%	1%	--	3%
Total	7%	5%	39%	38%	11%	0%	100%

Source: Survey data analysis

[1] Percentages are given in the table.

Table 3.3: Relationship between the changes of income versus changes of business after the COVID-19

	Not changed	Declined	Totally lost	Improved
No effect from the COVID-19	1%	1%	0%	0%
Not relevant	28%	35%	3%	2%
Will change the business type	1%	5%	1%	0%
Will close the business	0%	1%	1%	0%
Will go on a business loan	0%	2%	1%	0%
Will be normal after the crisis	2%	9%	1%	0%

Source: Survey data analysis

For further illustration it can be investigated whether there is a relationship between income shifting and fluctuations of business in the household. Table 3.3 illustrates no relation between variables and thus decline or loss of income is a temporary event and the majority of the respondents will recover it in the post-COVID-19 conditions.

The COVID-19 impact on household expenditure

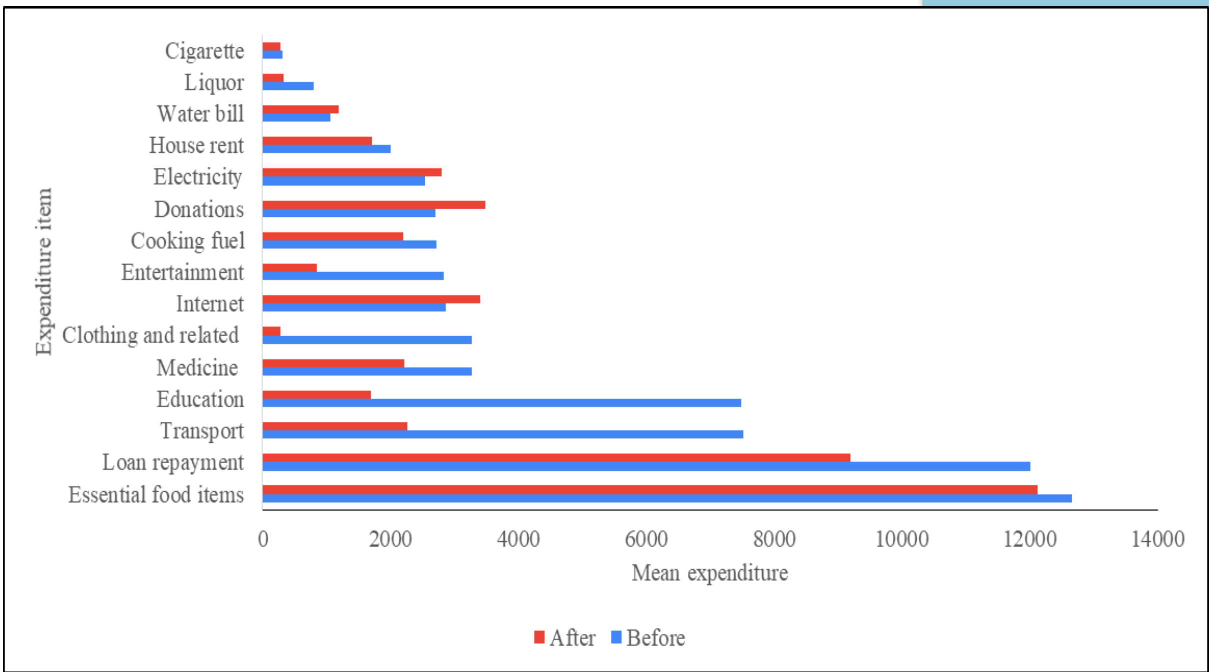


Figure 3.6: Comparison of before and after mean levels of expenditure per household

The outbreak of the COVID-19 unpredictably changed every aspect of daily lives, and consumer spending is no exception. Generally speaking, spending declined since closure of all entities such as restaurants and shops. And even no means of travelling as lockdown measures have restricted public movements. Therefore, consumers are less inclined to spend more due to two reasons. First is the restricted income and second is the limited means of spending.

Figure 3.6 illustrates the before and after mean expenditure on different expenditure items selected. As Figure 3.6 reveals, people have cut down their expenditure on many items after the COVID-19 pandemic. The costs of items of education, transport, entertainment expenditure, medicine and loan repayment are the expenditure of items that declined. It can be assumed that all these changes are provisional and thus, people will be on the same track in the post-COVID-19 period. These reductions are acceptable since schools and all the tuition classes completed closed down, there was no chance for entertainment activities due to mobility restrictions and lockdown regulations and reduction in loan repayment since the debts and leasing instalments were to be subject to a few months' moratorium. At the other end, electricity bills, internet cost and donations have noticeably increased. It is natural and acceptable that electricity and internet cost is more during the period of the COVID-19 pandemic due to the lockdown of the country, keeping all household members at home with mobility restrictions. One important aspect of this is that donations have increased by people who can afford them, compared to the pre-COVID time-span. Sri Lankans have proven that they are having the power to improve others' lives whenever possible and that is a privilege.

During the period of the pandemic and economic lockdown people have reached zero expenditure level for many items and thus they have made substantial savings.

Notably, the data also reveals that the economic impact of the lockdown has not been equally distributed across all layers of the community and places in the country. However, during the period of the pandemic and economic lockdown people have reached zero expenditure level for many items and thus they have made substantial savings within the household budget. Thus, it is important to know in which areas the people make savings and next section is examines the issue.

The COVID-19 impact on household savings

In a pandemic lockdown situation, savings will rise in two ways. The first category is the voluntary savings people build up to cushion a shortfall in future income due to possible job loss. The second category is the involuntary savings arising due to people not spending or under-spending in a lockdown.

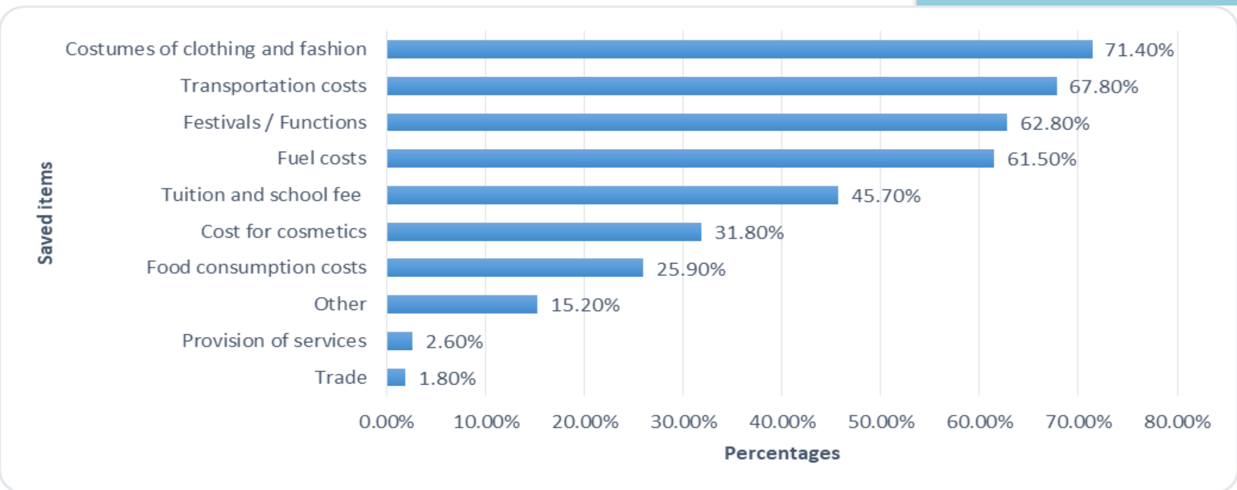


Figure 3.7: Contributors to savings during period of the COVID-19 and economic lockdown

Direct effects of the COVID-19 outbreak create destructive effects on households through loss of income, which limit their ability to pay off existing debts and consequently a severe financial stress.

As Figure 3.7 illustrates, the deferred expenditure on festivals and functions, costumes of clothing and fashion, transport and fuel cost and tuition fees are the significant areas where households made their savings. It was found that 2% of households experienced net losses instead of savings and the loss was estimated LKR 60,000 per household on average per month during the period of the economic lockdown. Fifteen per cent of households reported no loss or no savings. Average savings amounted to LKR 70,000 with a larger standard deviation. However, the median savings per household amounted to LKR 20,000.

The COVID-19 and indebtedness of households

It is reasonable to argue that the COVID-19 pandemic embodies an unprecedented shock to households around the world and there is no exception for Sri Lanka. These shocks are exploding to households through some direct channels including loss of employment because of the lockdown of the economy, and mobility restrictions due to curfew and social distancing. These direct effects of the COVID-19 outbreak create destructive effects on households through loss of income, which limit their ability to pay off existing debts and consequently a severe financial stress will be on them.

Expenditure on education, transport, entertainment, medicine and loan repayment have been declined and all these changes are provisional.

Therefore, the current research paid the attention to examining the indebtedness of households due to the COVID-19 outbreak. Figure 3.8 illustrates the effects of the COVID-19 on household debts.

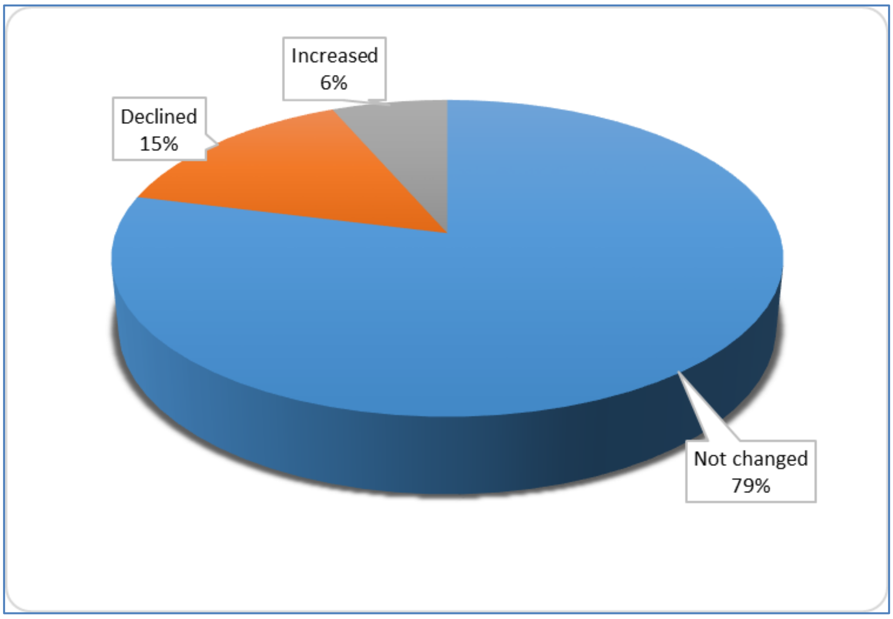
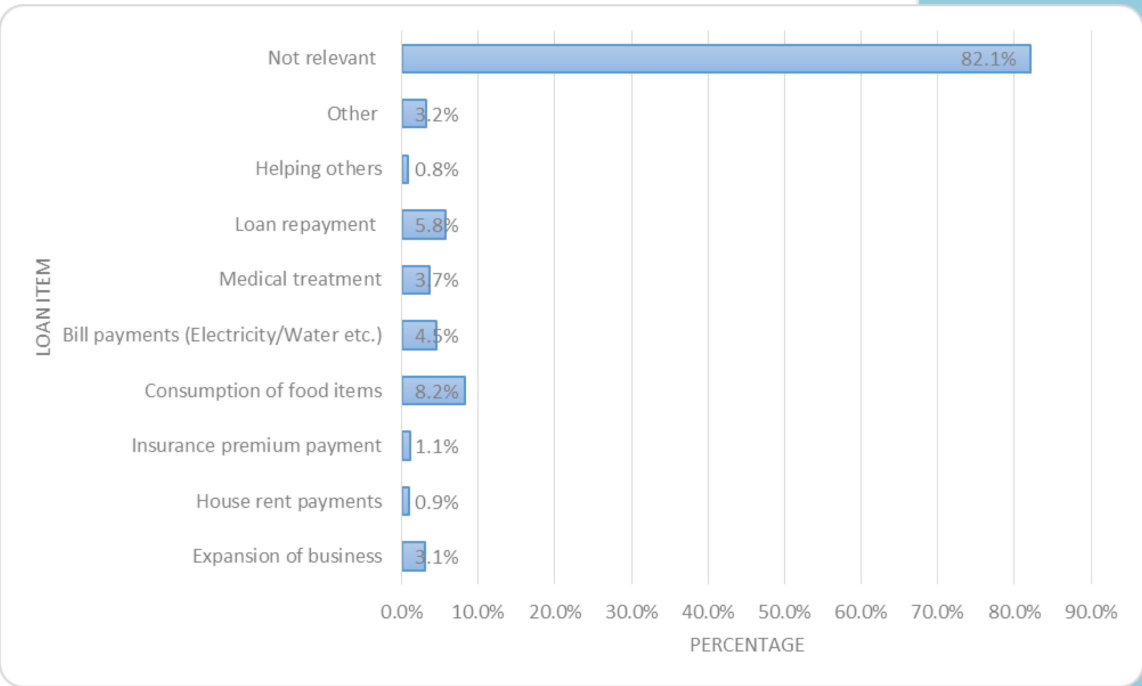


Figure 3.8: The COVID-19 impact on household indebtedness

It is impressive to observe that 79% of the households experienced no change in debt liabilities whereas only 6% of the households fell into indebtedness due to the COVID-19 outbreak. Therefore, it can be safely concluded that the COVID-19 has not created a debt trap for many of the households in the Sri Lankan economy. The information provided in Figure 3.8 can be shared to better understand the debt issues in households. As per the visual impression of Figure 3.8, more than 80% of household have not borrowed for any means. It is evidently compatible with the information given in Figure 3.8 that 79% of the households said that their indebtedness has not changed. Five to ten pe rcent of the households borrowed for loan repayments and daily consumption needs while a very small percentage of households borrowed for medical treatment and bill payments. Indebtedness has not much exploded on Sri Lankan household where just 8% of the households are requesting financial assistant for repayment of loans borrowed during pandemic. However, it does not mean that the households concerned are free from indebtedness. The data implies that they have maintained their debt liabilities during lockdown as at pre-COVID-19 the level. This outcome is the result of:

(1) Government/charity organization free food rationing programs
(2) Payment of 5000x2 payment for the most vulnerable families and *Samurdhi* recipients
(3) Debt moratorium of 3 months for bank loan and lease repayments
(4) Extending credit period of credit cards, deferring payment for water/ electricity bills, telephone/internet bills, without red notice or disconnection, extending vehicle licensing with no penalty.

All these factors imply that, except for permanent income holders, all other vulnerable income groups are very likely to fall into inevitable indebtedness in three months' time, unless their income



sources are reinstated at the pre-COVID-19 level.

Figure 3.9: Loan categories of households during pandemic

The COVID-19 and employment status of the household

With the rapid increase of the COVID-19 cases in the country, the Sri Lankan Government restricted access to in-dining restaurants, theatres, concert halls, some retail stores and other non-essential businesses where large groups of people work.

Additionally, public health officials, GOSL and other relevant authorities have warned Sri Lankans to stay at home. Many other businesses have voluntarily decided to close down to protect

The COVID-19 has not created a debt trap for many of the households in the Sri Lankan economy.

employees and the public as a whole. Meanwhile, the GOSL declared four days of "work from home," implementing nationwide curfew for the safety of public sector workers and decided to continue the impermanent curfew throughout the country. These decisions unfavourably affected the livelihood of the households and directly affected the employment status of the country. Therefore, the current research endeavoured to examine the reality of the employment status of Sri Lankan households during the pandemic. Respondents were requested to report what happened to their employment status due to the COVID-19.

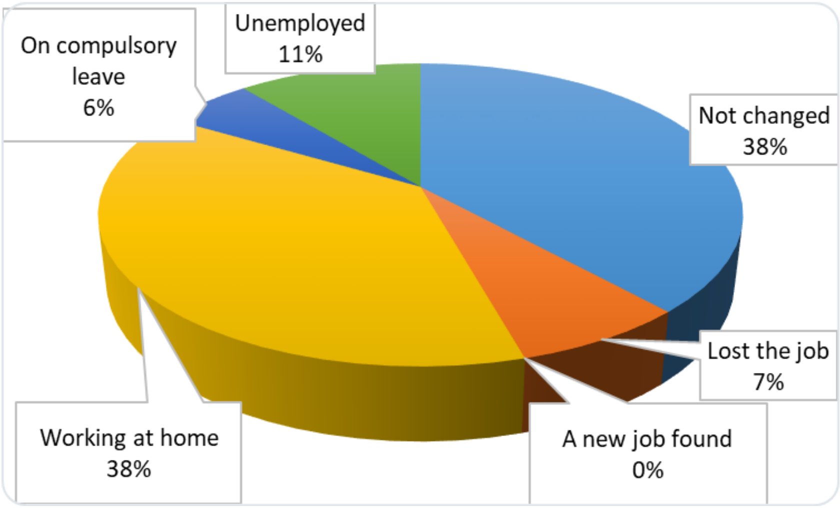


Figure 3.10: Changing employment status due to the COVID-19 pandemic

Figure 3.10 portrays the experienced employment behaviour due to the COVID-19 outbreak. According to the information available from the survey, 82% of the households are protected since they have a permanent position in their career. Seven per cent of households totally lost their employment opportunities. While millions of the workers are laid off around the word due to the COVID-19 outbreak, Sri Lanka is in a strong position to protect the employment status of the households. The most vulnerable group of employees is the people who worked in informal sectors, particularly on a day payment basis.

According to the survey data, "daily basis workers" and employees from informal sectors are the most vulnerable groups due to the pandemic. -Ninety-two per cent of the households claimed that daily basis workers are vulnerable to pandemic shocks while 80% of the households claimed that three-wheeler owners are also vulnerable.

Government decisions unfavourably affected the livelihood of the households and directly affected the employment status of the country.

However, most part of the temporary unemployment were disappearing when the report was being finalized. The most vulnerable employees are people who were directly and indirectly attached to the tourism and travel industry. Although more unemployed people will be backed in to their workplace in the post-COVID-19 period, employees attached to travel and tourism have to wait for a long time period until the industry is normalized, and thus, government intervention is required.

The COVID-19 and once for all monetary shocks to households

The COVID-19 has had unprecedented socio-economic impacts on Sri Lankan households through different channels. Due to the sudden economic lockdown of the country, implemented health precautions such as social distancing and implementing of nationwide curfew regulations, the Sri Lankan economy has shrunk unexpectedly. As a result, many businesses lost their profit and individuals and organizations abruptly lost their instantaneous income as well. Current research has paid attention to these issues and requested the respondents to report the unforeseen financial loss of the last month as well as the unexpected one-time financial loss during the last month.

Daily basis workers and employees from informal sectors are the most vulnerable groups due to the pandemic.

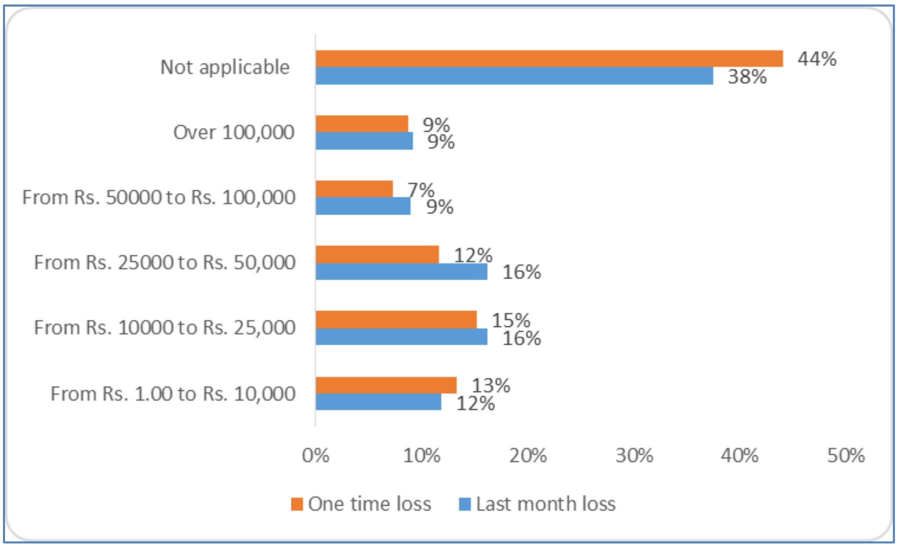


Figure 3.11: Financial loss due to the COVID-19 pandemic

Figure 3.11 describes the financial loss of households for entire last months and for one time lost during the pandemic. Financial loss is not applicable to many households while the remaining households (approximately 60%) had experienced a particular level of loss. It is apparent that there is no significant difference between onetime financial loss and one-month financial loss for all households that have faced a loss. It is important to investigate what kind of loss has been experienced by many households and thus respondents were requested to report the type of damage they have undergone. Figure 3.12 illustrates the summary of sources of financial losses. High internet costs, electricity bills, loss of private tuition teaching, loss of overtime payments, and closure of service stations, disruption of business due to the lockdown and partial loss of salary are the significant sources of financial losses of households. No significant losses are observed from the agriculture, farming and animal husbandry.

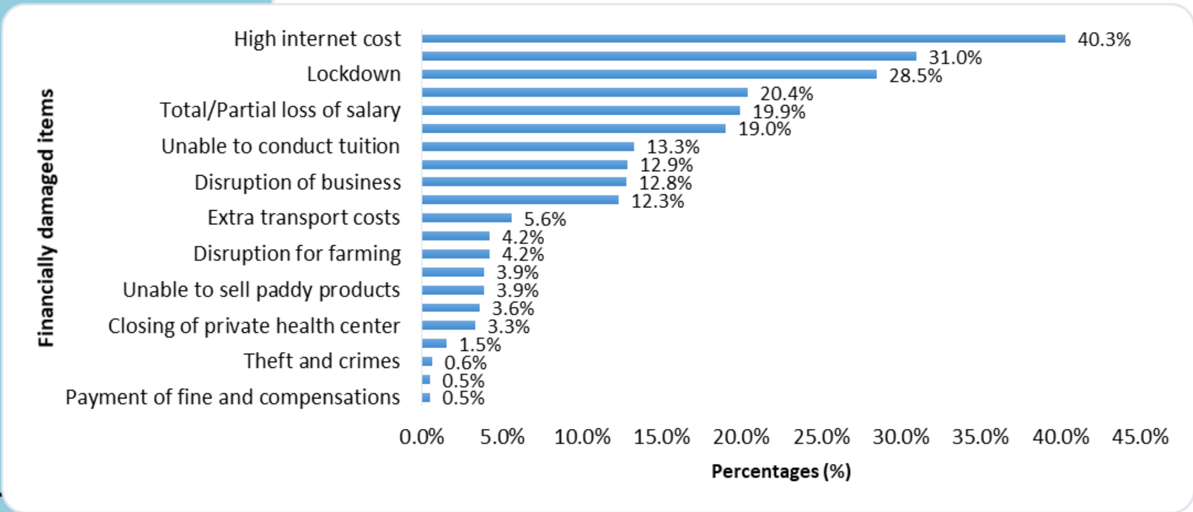


Figure 3.12: The source of financial damage to households.

No any kind of financial loss for 40% of the households.

It is apparent that there is no significant difference between onetime financial loss and one-month financial loss for all households.

The COVID-19 impact on household assets base

Maintaining a substantial level of assets by households brings the benefits such as generating income, more consumption, generating future assets and self-sufficiency. Households are generally sustaining different kinds of assets for the betterment of the household economy and thereby for a quality livelihood of its members. Therefore, maintaining a particular level of assets produces positive effects on the household, but occasionally, a negative impact on the national economy. These assets can be categorized into many categories and this research is interested in two types of assets; namely, financial assets (liquid assets) and real assets (fixed assets).

This research attempted to investigate the effect of the COVID-19 on the changes of both types of assets by comparing the pre-COVID-19 and post-COVID-19 levels. Figure 3.13 presents the impact of the COVID-19 pandemic on fixed assets and it reveals no substantial effect on those assets. Approximately 10% of households have mortgaged their jewellery and related items such as mobile phones to solve temporary liquidity problems but there was no substantial effect on other types of real assets.

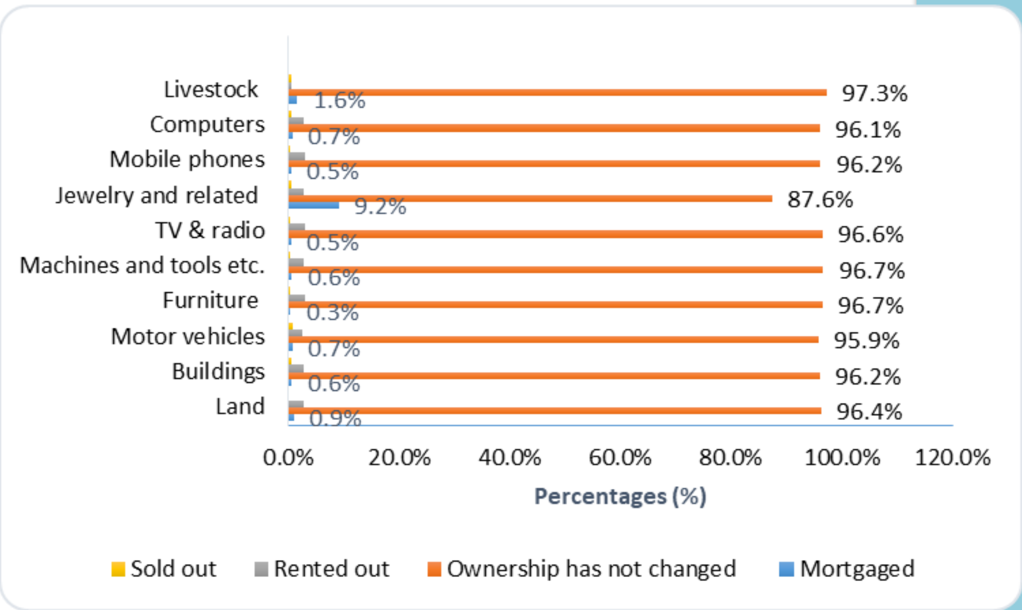


Figure 3.13: Effect of the COVID-19 on fixed assets of households

No significant losses are observed from the agriculture, farming and animal husbandry.

Figure 3.14 presents the effects of the COVID-19 on financially related assets and liabilities. On the one hand, where the assets are concerned, it is noticeable that cash balances and current/savings account balances markedly declined. On the other hand, when the liabilities are concern credit card outstanding balances, borrowings and procrastinated leasing instalments have considerably increased.

Although not repeated here, all the unsettled water/electricity/ telephone/internet bills need to be considered as increased liabilities of the household. The dual action of liquidation of financial assets and accumulation of financial liabilities imply that these households are now compelled to suffer financial distress due to the COVID-19. The government has already advised commercial banks to adjust the credit period and minimum balance of the credit cards in favour of the customer. Nevertheless, the government should not undertake any financial liabilities of households but needs to take corrective measures to sustain their livelihoods enabling the households themselves to meet their liabilities.

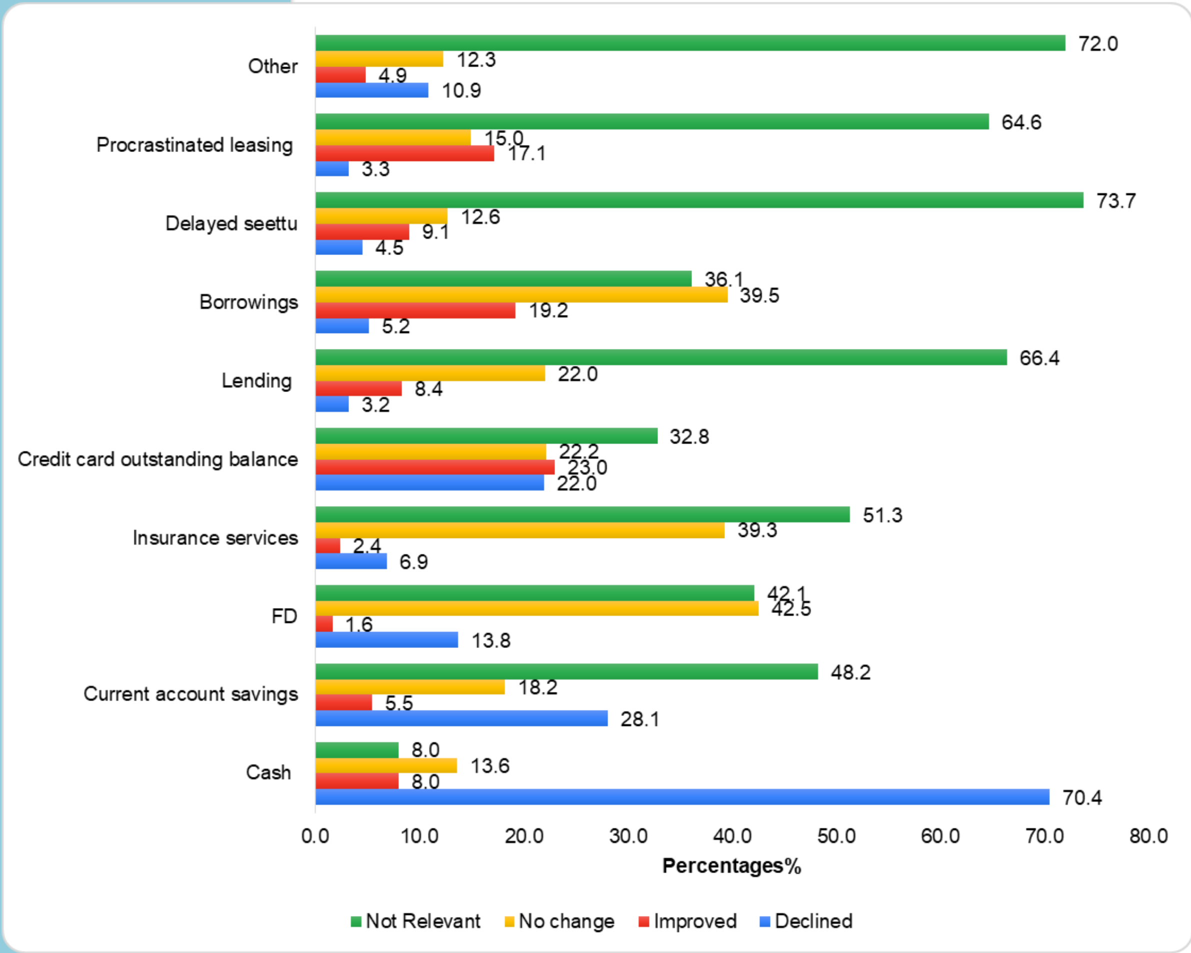


Figure 3.14: Effect of the COVID-19 on household assets

The dual action of liquidation of financial assets and accumulation of financial liabilities imply that these households are now compelled to suffer financial distress due to the COVID-19.

Mostly vulnerable and economically hard hit groups due to the COVID-19 in Sri Lanka

Economic implications of the COVID-19 are unprecedented and all the sectors of the economy have been affected. According to media, the most vulnerable group of people due to the COVID-19 pandemic is the daily wage workers and thus the government of Sri Lanka initiated relief packages for them to sustain their livelihood. There were discrepancies in distributing these relief for people and many arguments in selecting the hard hit persons due to the pandemic. Therefore, the current research decided to investigate the most vulnerable groups in the economy. Respondents were requested to identify 10 groups experiencing economic hardship due to the

COVID-19 in their surroundings. Figure 3.15 presents the summary of the findings:

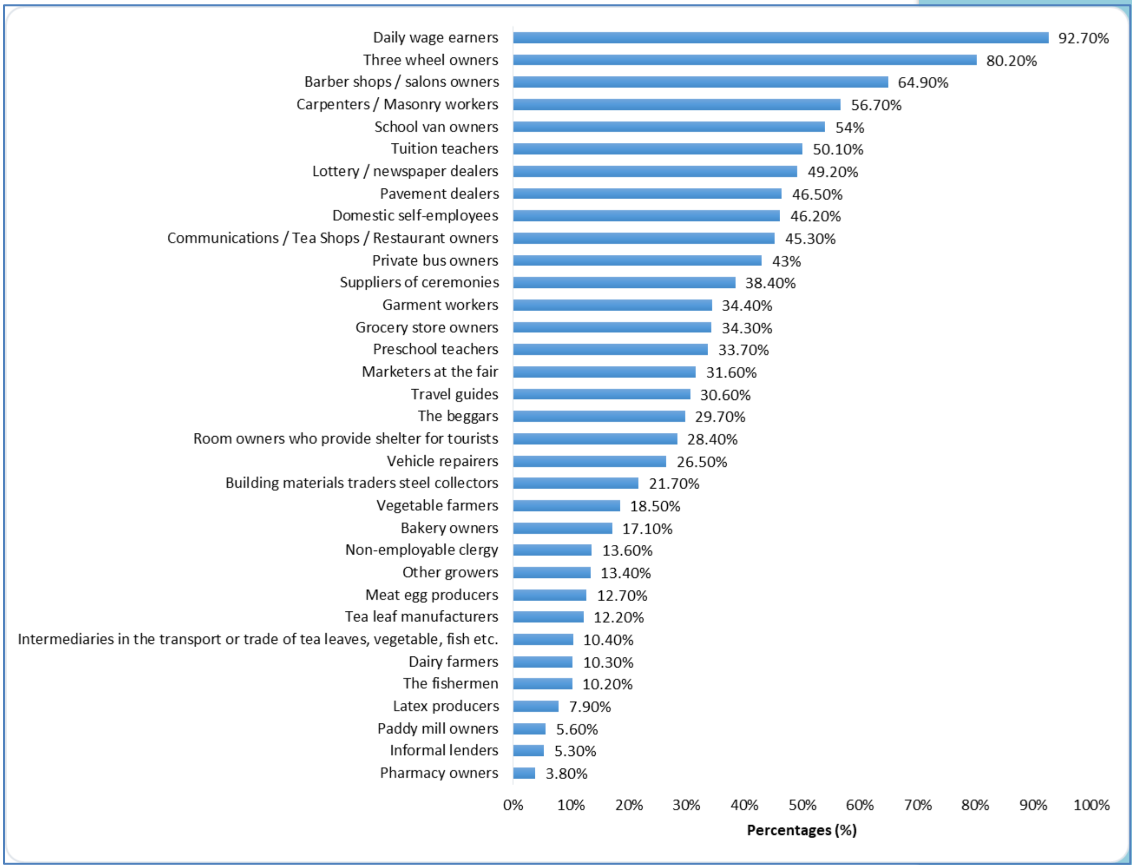


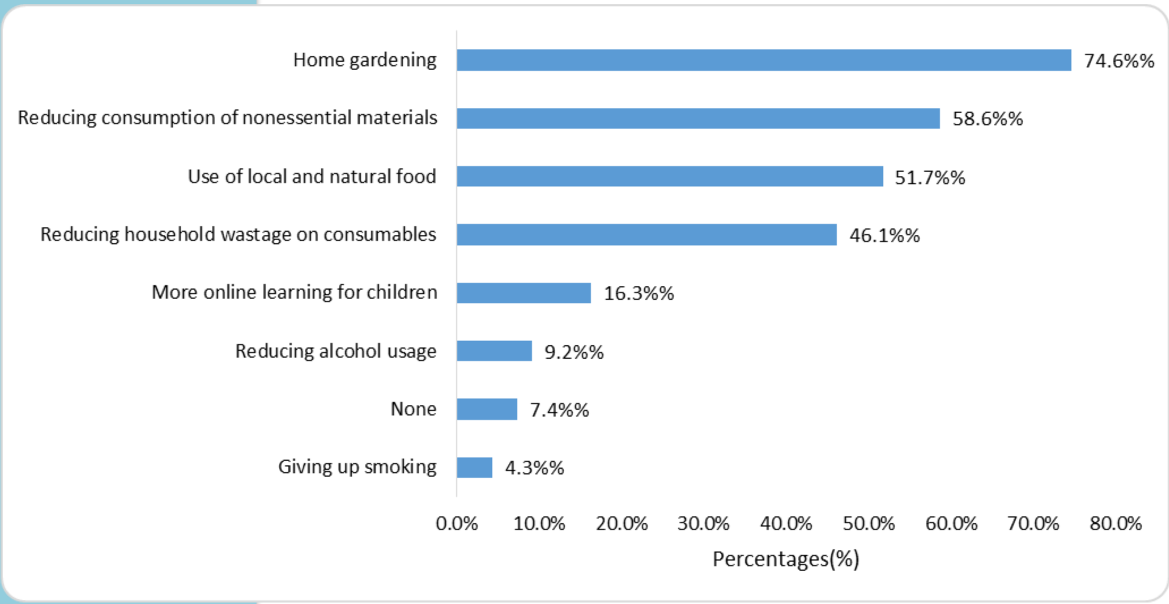
Figure 3.15: The COVID-19 most affected categories in the economy

According to the survey, daily wage earners, three-wheel owners, barber shop/salon owners, tuition teachers, lottery and newspaper dealers, domestic self-employees, carpenters and masonry workers, school van owners, lottery/newspaper dealers, and pavement hawkers are the order of severely affected segments of the COVID-19. However, daily workers are the most vulnerable since it is impossible for them to recover the income foregone soon after the outbreak, compared with many other groups. However, the loss to many other segments is not limited to the income foregone, but includes the fixed cost they have to bear (monthly rental for business premises) even in the absence of an income.

Post-COVID-19 expectations of households

New habits

It is undebatable that behaviour of Sri Lankan households has undergone many drastic changes in different aspects and consequently there will be some changes on the economy and the society in the post-COVID-19 pandemic. Therefore, the research team was encouraged to collect such data on the good practices they started during the lockdown and expect to continue even after the COVID-19 pandemic. Figure 3.16 is one such presentation. Sri Lankans have changed their minds and practices with the new COVID-19 outbreak. The government of Sri Lanka encouraged home gardening and as a result about 75 % of households are ready to continue home gardening during the post-COVID-19 period as well. It is a noticeable change in society.



About 75 % of households are ready to continue home gardening during the post-COVID-19 period

Figure 3.16: Habits to be continued after the COVID-19 pandemic by Sri Lankan households

Economic, social and environmental benefits can be seen in home gardening. In terms of economic benefit, self-sufficiency can be enhanced among growers. Further, it generates additional income and thereby improves the livelihood of the households. Consumption of home-grown food products can lead to retaining more disposal income that can be used for other domestic purposes, improving household welfare. Households are planning to reduce consumption of non-essential goods materials and thus, they have learnt a lesson from the COVID-19 outbreak and they will be able to save money. A noticeable percentage of households have understood that they are wasting consumables due to insensibility. It is unbelievable that Sri Lankans waste food items everywhere, be it at homes, restaurants, or hotels. People in another part of the world are in starvation for days and months due to lack of food items. Therefore, reducing wastage consumables will have an economic impact as well.

Further, a substantial portion of households are ready to continue the habit of the consumption of natural, local and organic foods. Protection for the local industries and generating additional jobs in the economy are some of the direct economic advantages achievable with the rising demand for local and natural foods. Indirectly, people of the country will maintain a healthy life and thereby reduce government expenditure on the free provision of health service. The research revealed that the households do not have strong plans to reduce smoking and alcohol usage. This was further proven by the long queues lined up when liquor bars were reopened. Thus, the government should have no fear of losing tax income on tobacco and liquor, which is the topmost excise duty source of the government.

More than 50% of households are not requesting any kind of financial assistance during the post-COVID-19 period.

Fulfilling financial difficulties

Since the COVID-19 wafted many direct and indirect impacts on households that have experienced financial difficulties during the pandemic period. This research was aimed at investigating what kind of strategies that the people practice in future in fulfilling the financial difficulties. Respondents were requested to mark any three important areas for financial assistance and Figure 3.17 illustrates the summary of the findings:

More than 50% of households are not requesting any kind of financial assistance during the post-COVID-19 period while around 45% of households are seeking financial support for loan repayment, freeing mortgaged items, to settle outstanding balance of credit cards among these loan repayment being the most required item and thus, financial institutions need short-term as well as long-term plans with government involvement to mitigate the financial distress of the households. The current debt moratorium introduced by the Central Bank for three months would provide only a cushion. The liabilities will be accumulated and both the borrower and the lending institution will be in trouble after these months, unless the borrower's income sources are not regained.

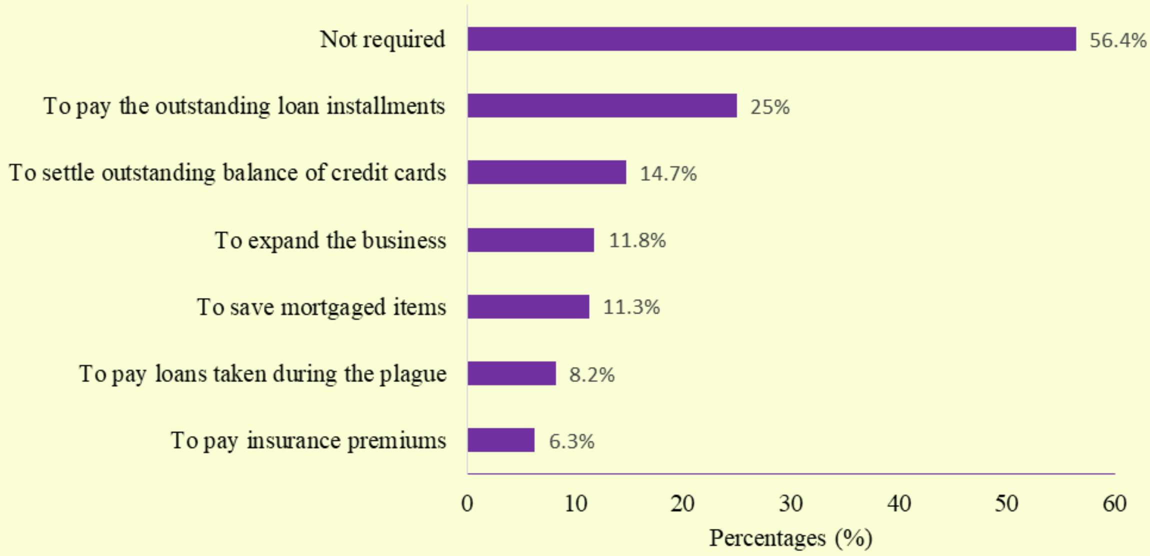


Figure 3.17: Financial assistance required to address financial difficulties due to the COVID-19

Technical assistance for regaining household economy

The COVID-19 outbreak affected entire household activities including the business activities they were maintaining. At the other end, the economy is experiencing a downturn of the many sectors. In such a context people may hope to request many kinds of assistance to regain the business and/or livelihood of the households. Therefore, the research team endeavoured to search for such needs and Figure 3.18 is the result.

Priority areas for technical assistance are agriculture, initiating a new business, investment-related and finance-related.

Approximately 55% of households are not expecting any kind of assistance since they have no kind of permanent damage due to the COVID-19 and most probably the members of those households comprised government and/or private sector permanent employees. Priority areas for technical assistance are agriculture, initiating a new business, investment-related and finance-related. Forty-five per cent of households are expecting some type of advice for their betterment and thus, government intervention is important.

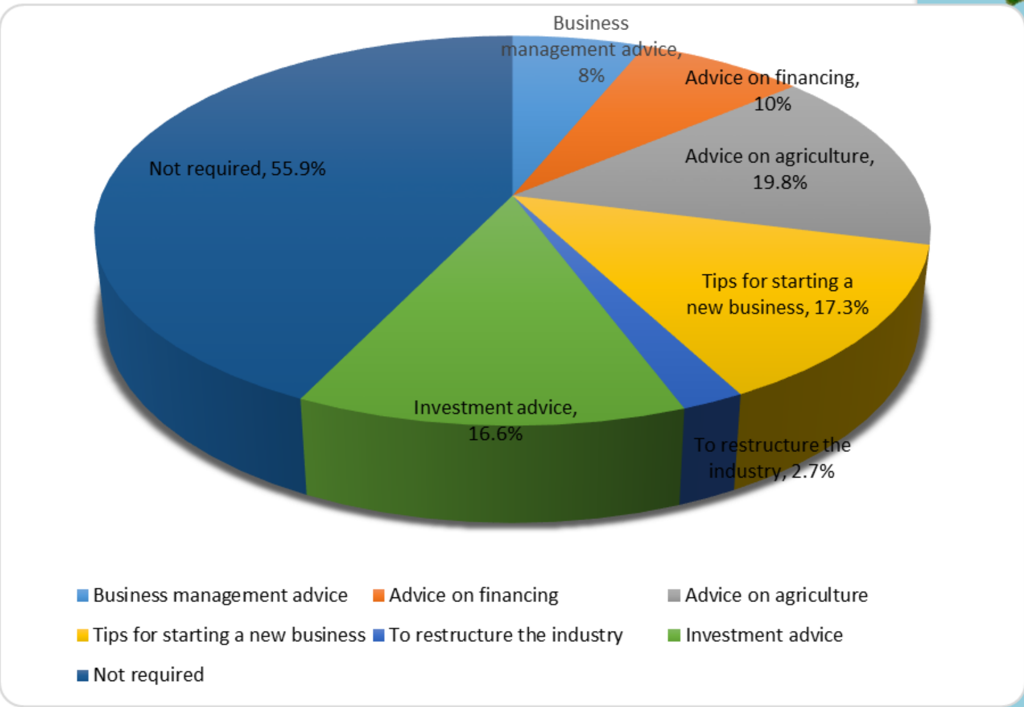


Figure 3.18: Type of expected technical assistance after the COVID-19 pandemic

Formal or informal organizations, which are called social capital formation, play an important role in such situations like the COVID-19 outbreak. Therefore, 78% of households are happy to form such an organization in their surroundings for mutual assistance among community.

3.4 Chapter summary

This chapter provides the results of the investigations of the COVID-19 impact on Sri Lankan households. The sample of 1087 households were analysed for the COVID-19 impact. Public sector employees were not harmed due to the COVID-19 outbreak. Seven per cent of the respondents lost their total income and these people were employed largely in the service sectors and are usually self-employed or informally employed in micro and family enterprises and they were the people who were in most danger during the lockdown period. In terms of expenditure, households saved money on the cost items of education, transport, entertainment, medicine and loan repayment, which are the expenditure declined items. It can be assumed that all these changes are provisional and thus, people will be on the same track in the post-COVID-19 period.

Public sector employees were not harmed due to the COVID-19 outbreak.

Seven per cent of the households lost their total income and these people were usually self-employed or informally employed in micro and family enterprises.

Most part of temporary unemployment was disappearing when the report was being finalized.

Seventy-five per cent of households are ready to continue home gardening during the post-COVID-19 period as well.

It is impressive to observe that 79% of households experienced no change in debt liabilities whereas only 6% have fallen to indebtedness due to the COVID-19 outbreak. Though indebtedness has not exploded on Sri Lankan household too much, where just 8% of them are requesting financial assistance for repayments of loans borrowed during pandemic. However, it does not mean that the households concerned are free of indebtedness. The data implies that they have maintained their debt liabilities during lockdown as at the pre-COVID level.

According to the survey data "daily basis workers" and employees from informal sectors are the most vulnerable groups due to the pandemic while 7% lost the entire job opportunity. The second most vulnerable group of employees were the three-wheel owners. However, the most part of temporary unemployment was disappearing when the report was being finalized. Although more unemployed people will be taken back into their workplace in the post-COVID-19 period, employees attached to travel and tourism have to wait for a long period until the industry is normalized and thus, government intervention is required.

High internet costs, electricity bills, loss of private tuition teaching, loss of overtime, and closure of service stations, disruption business due to the lockdown and partial loss of salary were the significant sources of financial losses of households. No significant losses were observed from agriculture, farming and animal husbandry.

The dual action of liquidation of financial assets and accumulation of financial liabilities imply that these households are now compelled to suffer from financial distress due to the COVID-19. The government has already advised commercial banks to adjust the credit period and minimum balance of the credit cards in favour of the customer. Nevertheless, the government should not undertake any financial liabilities of households but needs to take corrective measures to sustain their livelihoods, enabling the householders themselves to meet their liabilities.

Sri Lankan households have undergone many drastic changes in different aspects and consequently there will be some changes on the economy and the society in the post-COVID-19 pandemic. Seventy-five per cent of households are ready to continue home gardening during the post- COVID-19 period as well.

More than 50% of households are not requesting any kind of financial assistance during the post-COVID-19 period while around 45% of households are seeking financial support for loan repayment, freeing mortgaged items, and to settle outstanding balance of credit cards. The current debt moratorium introduced by the Central Bank for three months would provide only a cushion. The liabilities will be accumulated and both borrower and the lending institution will be in trouble after these months, unless borrower's income sources are not regained.

Approximately 55% of the households were not expecting any kind of assistance since they have no any kind of permanent damage due to the COVID-19 and most probably the members of those households comprised with government and/or private sector permanent employees. Priority areas for technical assistance are agriculture, initiating a new business, investment -related and finance-related. Forty-five per cent of households are expecting some type of advice for their betterment and thus, government intervention is important.

Forty five per cent of households are seeking financial support for loan repayment, freeing mortgaged items, and to settle outstanding balance of credit cards.

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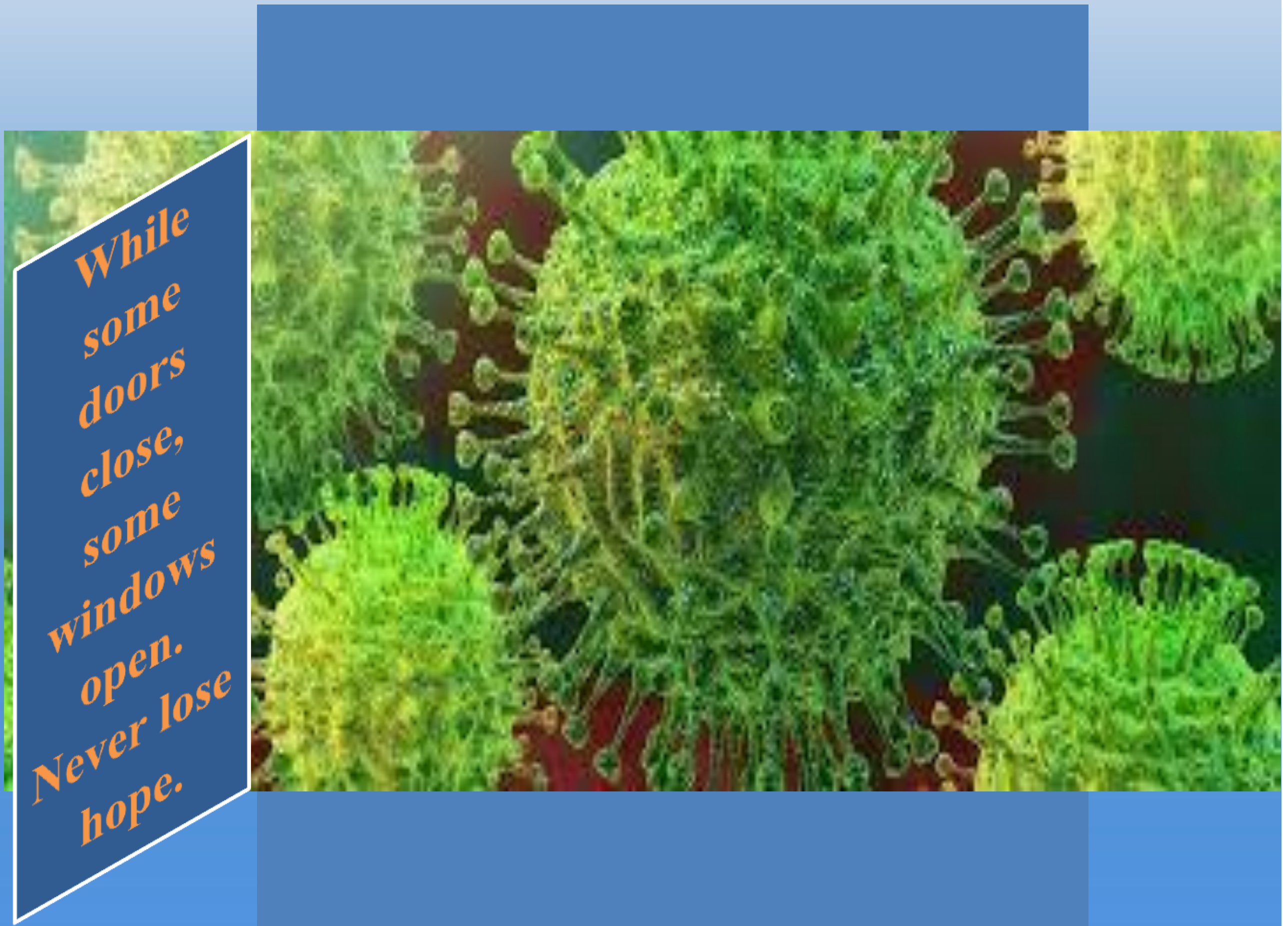
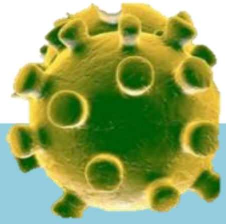
CHAPTER IV

THE COVID-19 IMPACT ON DIVERSE SECTORS IN THE SRI LANKAN ECONOMY





The COVID-19 Impacts on Diverse Sectors in the Sri Lankan Economy

4.1 Introduction

The novel Coronavirus termed "COVID-19" was first identified in China in December 2019. Thereafter, it significantly blew out across borders and harmed countries around the globe. The World Health Organization (WHO) declared Coronavirus as the COVID-19 pandemic on 11th March 2020. With the continuous outbreak of the pandemic, governments around the world laid a variety of health measures to save the public. Consequently, travel bans, nationwide curfews, social distancing measures, movement restrictions and even border closures have been imposed. The introduction of such health measures adversely affected the livelihood of people, businesses, communities and households alike while creating severe impacts on the global economy as well as regional economies and Sri Lanka is no exception. Each and every sector, including travel and tourism, construction, banking and finance of the Sri Lankan economy, was severely hit hard by the COVID-19 and this section of the research investigated the COVID-19 impact on some selected areas of the Sri Lankan economy.

Each and every sector, including travel and tourism, construction, banking and finance of the Sri Lankan economy, was severely hit hard by the COVID-19

4.2 Micro, small and medium-scale enterprises

Introduction

The MSME sector in Sri Lanka consists of Micro, Small, and Medium scale industries. MSMEs have been significantly contributing to the Sri Lankan economy until the COVID-19 pandemic. The number of establishments in the MSMEs is around one million, which provides livelihood to nearly 2.25 million persons in the economy (Gunawardena, 2020).

The MSMEs' production activities of the economy of Sri Lanka are mainly concentrated on three major economic sectors, namely, (a)

Industry and construction, (b) Trade and, (c) Services. It shows that 91.8% of the establishments in the country are micro-enterprises, whereas 7% are small, 1% are medium and the balance 0.2% are large enterprises (Department of Census and Statistics, 2015).

The contribution of MSMEs to gross domestic product (GDP) is 52% 20% of exports, 30% of the production value-added in the manufacturing sector and 45% of the total employment of the labour force (Gunawardena, 2020; Ministry of Industry & Commerce, 2015). Therefore, The MSME sector can be considered as one of the major growing sectors in the economy. The MSME sector is one of the mostly contributed sectors for rural economy in the country since approximately 92% of the establishments are in the category of small scale (Gunawardena, 2020).

Impact of the COVID-19 pandemic on MSMEs in Sri Lanka

Information covered in this section is based on nearly real-time evidence which was gathered from in-depth interviews with Micro, Small and Medium Enterprises (MSMEs) experts from different districts in Sri Lanka as well as a thorough review of research literature published by relevant authorities on the impact of the COVID-19 pandemic.

The COVID-19 pandemic has caused unprecedented challenges for MSMEs in Sri Lanka that include difficulties in cash flows, breakdown in supply and demand chains, reduction of employment, and rigorous decrease in both market supply and demand for goods and services of enterprises.

Demand disruptions for goods and services of MSMEs are mostly due to (1) contraction of aggregate demand in both domestic and foreign purchase, (2) wait-and-see purchase delays by consumers domestically, under a partial lockdown situation. Almost all the production activities of MSMEs significantly hit by the COVID-19 pandemic while employees were also suffered.

Many MSMEs in Sri Lanka significantly failed in business as they had been unable to diversify their production processes before or immediately after the COVID-19. Focus group discussions revealed that the weak production structures in many organizations caused to aggravated conditions of their businesses due to the COVID-19.

The COVID-19 pandemic has caused unprecedented challenges for MSMEs in Sri Lanka that include difficulties in cash flows, breakdown in supply and demand chains, and reduction of employment.

Staff salary payments, loan instalments, and rent for space are the main operational cost of MSMEs in Sri Lanka during the pandemic, of which the difficulties in paying staff salaries are highlighted as the sensitive prime issues for 50% to 70% of MSMEs (Focus Group Discussions, 2020). According to in-depth interviews, it is reported that 10% to 20% of enterprises are suffering from paying loan instalments while rental payments for premises as an issue which accounts for 15% to 20% of enterprises. The in-depth interviews indicate that if the impact of the COVID-19 further continues, MSMEs will resort to measures such as layoffs and salary cuts to reduce costs.

However, the transformation of most MSMEs for the sudden situation has been hindered by a lack of resources (obtaining raw materials), capabilities, strategic vision, and negative attitudes towards the production process of the enterprises.

In creating an unfavourable impact on both supply-side (production of goods and services) and demand-side (consumption and investment), industry and service sector enterprises in Sri Lanka (beauty salon, salon, basic metal product, leather product, small-scale textile product, and cement related business) have most severely been hit hard by the COVID-19 pandemic.

Almost 60% of the micro enterprises have not kept up their account properly and thus, they have no clear mechanism for calculating their cost of production. There is no proper mechanism to distinguish profit from the total revenue. They treat the remainder after paying all the purchase not including their cost of labour as a profit, which is wrong. This is an inherent issue for the majority of microenterprises in Sri Lanka. Accordingly, all microenterprises are severally opened to deterioration of their financial position under unexpected events like the COVID-19 pandemic.

Almost 60% of the micro enterprises have not kept up their account properly and thus, they have no clear mechanism for calculating their cost of production.

The most severely affected enterprises were the "Accommodation and food service sector," which is the major part of the tourism industry. The tourist guides, stores of restaurants, hotels, motels, lodges and guest houses, logistics and transportation, and cultural-related activities are severely hit by the COVID-19 pandemic.

The number of establishments in the accommodation and food service sector is around 100,000 that provides 200,000 employment opportunities for the persons in the economy (Department of

Census and Statistics, 2015). Thus, the above sector generally finds supporting policies focused on operating costs reduction or exemption, production, and work resumption promotion during these unprecedented times.

It is required to develop and encourage the use of online sales channels as a potential strategy to accomplish unstable market conditions with the production process of the enterprises.

Nearly 10% of MSMEs have got through to adjust their business strategies to suit the requirements which arose under the pandemic environment. Especially, some MSMEs in the apparel and textile industry in Sri Lanka have shifted their production procedures to manufacturing respirators and protective clothing such as face masks. This not only supports the enterprises to sustain their cash flow without any hindrance under the current crisis but also guides them to enter the growing new markets with possible future expectations.

Due to the loss of buyers from foreign countries under partial lockdown, export-oriented enterprises such as small-scale household-based textiles and garments activities, gems, diamond and jewellery, ornamental fish farming, ornamental floriculture, spice production, coconut-related production, and minor export crops, have been severely hit under the COVID-19 pandemic. Further, the enterprises, which are the major suppliers for the export market, faced contraction of demand for textiles and garments, gems, diamond and jewellery, ornamental floriculture and spices, especially from countries such as China and America and Europe, which are the worst affected countries by the COVID-19 pandemic.

Due to the loss of buyers from foreign countries under partial lockdown, export-oriented enterprises such as small-scale household-based textiles and garments activities, gems, diamond and jewellery, ornamental fish farming, have been severely hit under the COVID-19 pandemic.

Despite the negative impact of the COVID-19 pandemic on MSMEs, nearly 15% of MSMEs have benefited under the current crisis. Retail and wholesale trade, *Ayurveda* medicine activities, and computer sales have been continuing their business situation without creating any burden on their sales under the existing crisis.

Another positive outcome of the COVID-19 pandemic is that it has generated new business models, such as staff sharing for the whole economy, including MSMEs in Sri Lanka.

To address the financial issues of the enterprises, a SMEs' friendly banking system shall be established under the patronage of the government and the Central Bank of Sri Lanka.

Policy priorities

The following recommended guidance could be put forward to ensure the orderly resumption of MSMEs' production, strengthen financial support, innovation support, public services, and overall MSME coordination in aiming to rebuild a sustainable basis for MSMEs in Sri Lanka.

- The government and other responsible authorities shall coordinate the domestic and foreign markets to sell the unsold excess production of enterprises during the COVID-19 pandemic. These immediate initiative steps will guide to cover the sunk costs as well as to reduce the financial pressure of the most affected enterprises due to insufficient cash flow.
- The government-led formal mechanism should be established for developing linkages between MSMEs and other complementary institutions, which will guild to maintain the sustainability of enterprises against unexpected events like the COVID-19 pandemic. Promotion of Public-Private Partnership Strategy (PPPS) for enterprises and the establishment of planned cluster-based enterprises may be the viable masterstroke for the future enterprise development scenario in Sri Lanka.
- For MSMEs with insufficient cash flow, the government shall implement sound financial support policies to help enterprises to minimize their financing difficulties which are the major problems encountered during the COVID-19 pandemic. Meanwhile, continuous policy packages shall be introduced especially covering all areas of micro-enterprise activities to sustain their long-term production process and expectations as well as to secure from the risk of future emergencies based on the COVID-19 experience.
- To address the financial issues of the enterprises, an SMEs' friendly banking system shall be established under the patronage of the government and the Central Bank of Sri Lanka. Emergency financial supports for fragile SMEs could be one important component of the response. For the MSMEs that have temporarily lost their sources of income because of the COVID-19 pandemic, the Central Bank and other financial institutions should give priority when they apply for business guarantee loans.

- The government and other responsible institutions could also provide timely financial support such as loans at concessionary rates of interest, wage subsidies, deferred or waived taxes, and fees for MSMEs. For instance, The Central Bank's recent policy lending rate cut will also support MSMEs in Sri Lanka. Further, the Central Bank of Sri Lanka has recently taken policy decisions to support lending facilities by alleviating monetary conditions and enabling financial institutions to provide more loans to MSMEs, some of which are backed by refinance schemes.
- The Central Bank of Sri Lanka, as an apex institution of the financial system, in company with the Ministry of Finance has introduced refinance schemes such as *"Saubhagya"* and "Enterprise Sri Lanka" loan schemes for alleviating the financial burden of MSMEs. However, these loan schemes reached the enterprises with adequate collaterals, but not to all the enterprises. To empower the financial strength of MSMEs, the government should implement policies to increase project-based lending rather than collateral-based lending. Thus, the government should take action to initiate sound financial inclusion programmes targeting underprivileged micro-enterprises, especially under unexpected events like the COVID-19 pandemic.
- The relevant authorities take concrete action to introduce the required strategies to diversify the production process of MSMEs. Parallel to these processes, a viable programme should be implemented for sharing knowledge between R&D institutions and MSMEs under innovation support.
- The current pandemic has highlighted that special programs could be planned to emphasize the importance of risk management strategies for enterprises and enterprises can comprehend how these strategies help them to cope with their business under crises like the COVID-19 pandemic. The government of Sri Lanka should initiate sound policy guidance for implementing a suitable risk management strategy for MSMEs.
- A National SME Portal shall be established to keep important records of the enterprises in Sri Lanka. The portal may be operative 24 hours a day to receive problems and suggestions of MSMEs. The relevant institutions can examine

To empower the financial strength of MSMEs, the government should implement policies to increase project-based lending rather than collateral-based lending.

these issues and suggestions of enterprises for planning their timely support.

4.3 Impact on Sri Lanka stock market

The Colombo Stock Exchange (CSE) has 290 listed companies representing 20 Global Industry Classification Standard (GICS) industry groups as at 20th January 2020, with a Market Capitalization of LKR 2,748.10 billion. Before the CES closed on March 20th following the lockdown, the stock market's S&P SL 20 share index crashed by almost 12% to 1943.55, recording its biggest intra-day fall, (see Figure 4.1) while its benchmark All Share Price Index fell more than 6% to 4571.63 (see Figure 4.2) due to panic selling.

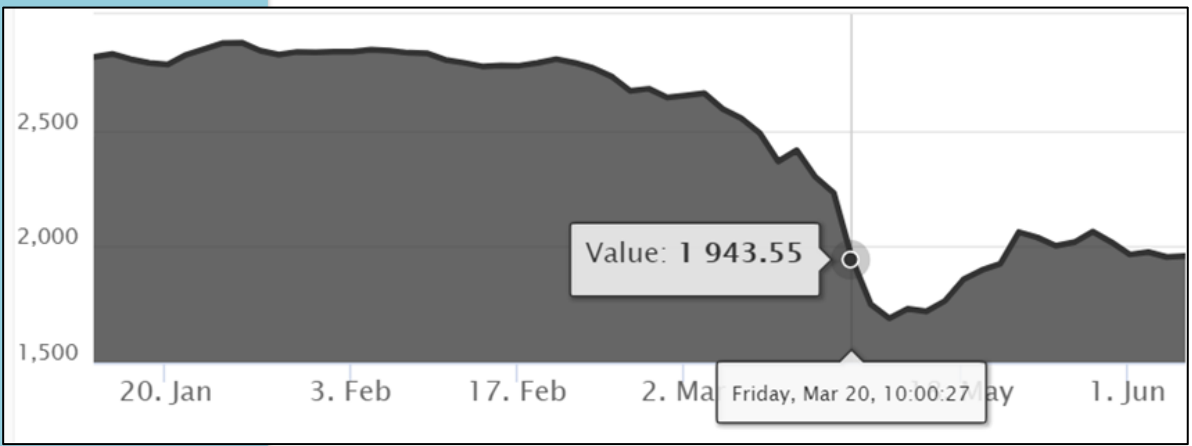


Figure 4.1: The behaviour of S&P SL 20 share index before closedown in March 2020

The market remained closed during the 51-day lockdown and was reopened on 11th May for trading. After reopening on 11th May, the CSE underwent automatic closure within a few minutes for the first time in history because the S&P SL 20 index had dropped more than10% from the previous close. The S&P SL20 Index ended 10.11% lower, at 1,750.49 points, while the All Share Price Index fell 4.10% to 4,384.10 points with the turnover of LKR 24.89 million at closure. The decline continued for the following two days, mostly driven by foreign investors' selling pressure and the S&P SL 20 index hit bottom at 1690.60 and ASPI hit at 4247.95 (See Figure 4.3 and 4.4).

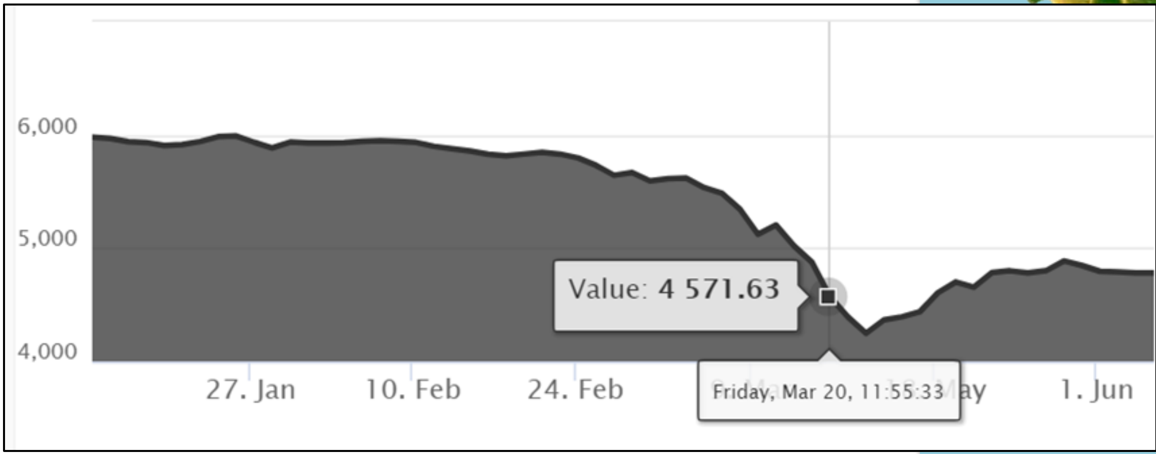


Figure 4.2: The behaviour of the ASPI before closedown in March 2020

This is quite natural because the market closed down on 20th March with strong selling pressure. The international stock markets also showed the same trends during the corresponding period due to the COVID-19 pandemic. For example NIKKEY Tokyo on 19th March, Dow-Jones USA and FTSE UK hit bottom on 23rd March. The MSCI World Index, which indicates stock market movements of 23 developed nations, fell by 34% from peak to trough within a month, down to its lowest ever since 2016. Similar to other economies, uncertainty over economic slowdown in Sri Lanka, led to a sell-off in the financial market and capital outflows. Despite the foreign selling pressure, the CSE turned up and showed a little improvement after 12th May. This implies that investor sentiments are becoming positive gradually.

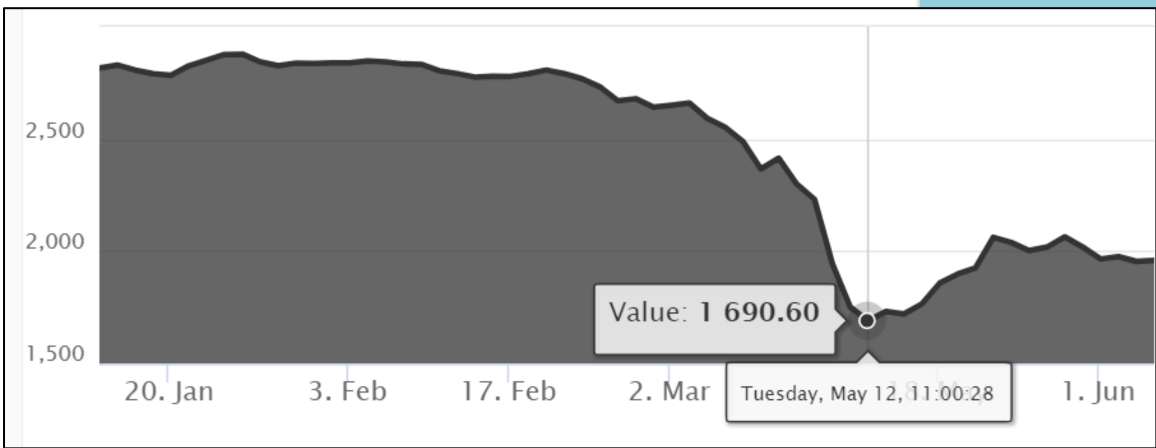


Figure 4.3: The behaviour of S&P SL 20 after reopening in May 2020

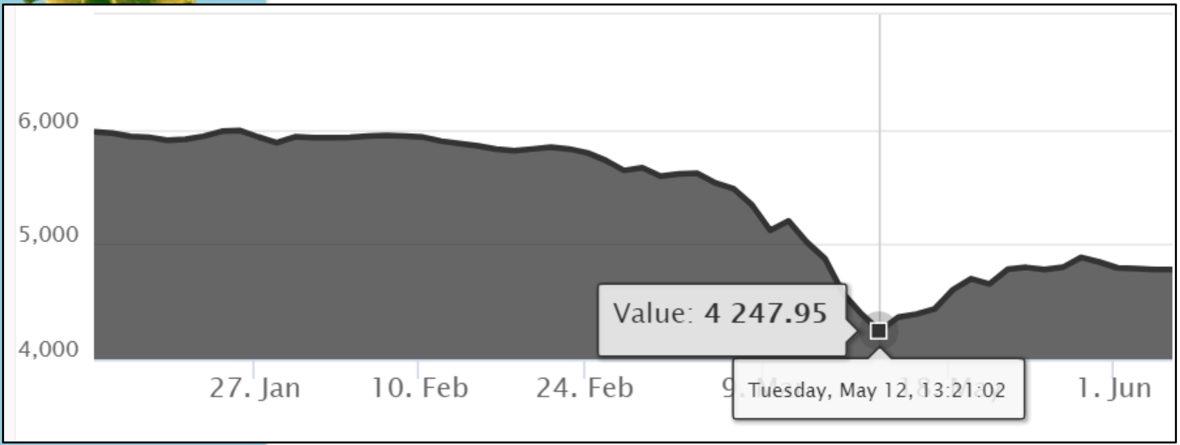


Figure 4.4: The behaviour of ASPI after reopening in May 2020

The COVID-19 pandemic has kept investors in suspense since February, putting markets into high levels of volatility, divestments, and flight into "safer haven assets".

Market analysts expect this situation to continue until the market settles down as both local and foreign investors are looking at exiting from risky assets due to the global pandemic. The COVID-19 pandemic has kept investors in suspense since February, putting markets into high levels of volatility, divestments, and flight into "safer haven assets". In addition to the COVID-19 impact, foreign investors must have taken into consideration the fact that Sri Lanka has been downgraded by international credit rating agencies (See Table 4.1). Investment analysts are of the view that there is no point in implementing circuit break rules. The investors must be allowed to sell their shares and the market must be allowed to function freely until it becomes normal.

Table 4.1 Sovereign Credit Ratings of Sri Lanka from 2018 to 2020

Agency	Rating	Outlook	Date
Fitch	B	Stable	3-Dec-18
Fitch	B	Negative	18-Dec-19
Fitch	B-	Negative	24-Apr-20
S&P	B	Stable	4-Dec-18
S&P	B	Negative	14-Jan-20
S&P	B-	Stable	20-May-20

Although the market indices started moving upward slowly, analysts do not expect the market would be fully recovered in the near future. The recovery depends on many factors, including the regaining of the leading business sectors of the economy, investor confidence, political stability, government policies and the global business environment. It is unrealistic to believe that the hard hit sectors such as tourism, constructions, aviation, automotive will be recovered soon. Furthermore, the political instability mounted by the forthcoming election, losing profitability of the firms, Sri Lanka's high credit risk, and poor fiscal conditions, will worsen the conditions. However, the low interest rates in the banking sector and deteriorating exchange rates will marginally help accelerate recovery. The CBSL, on May 6, cut benchmark interest rates for a third time since the COVID-19 outbreak to reinforce the economy against the fallout of the pandemic.

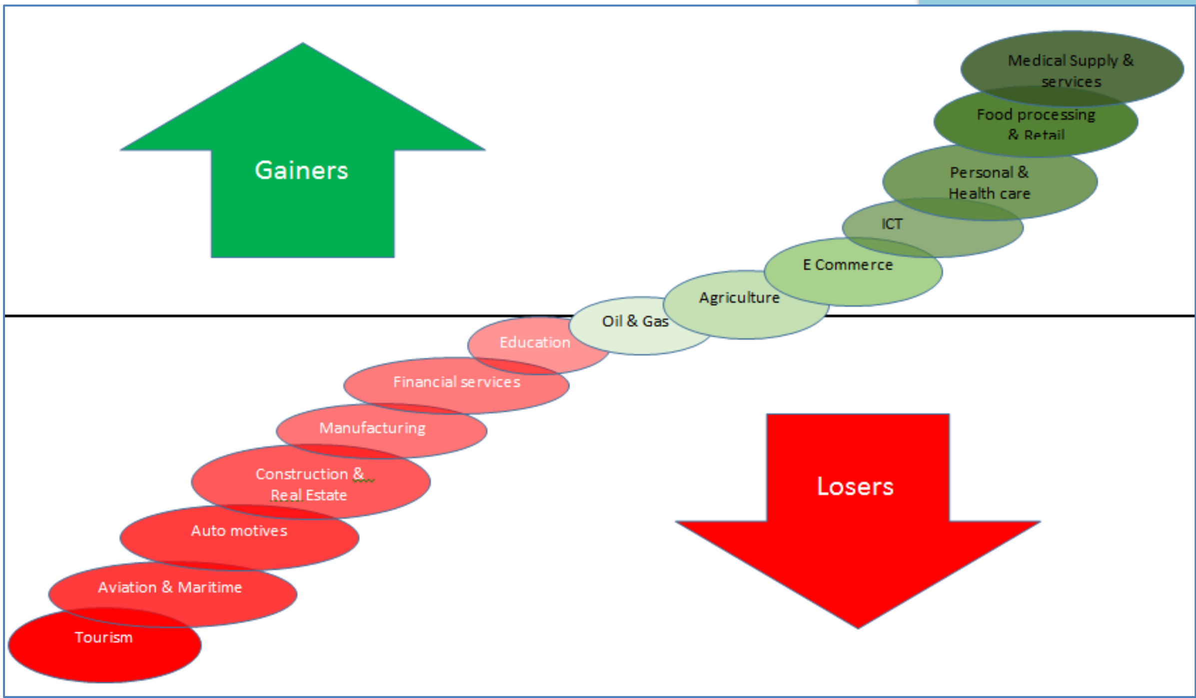


Figure 4.5: Potential gainers and losers in the stock market

The stock price, in absence of speculation, is a reflection of the company's business performance. The COVID-19 badly hit or devastated industry sectors such as tourism, aviation, automotive, constructions, manufacturing including textiles & garments, whereas marginally boosted some sectors such as agriculture, e-commerce, telecommunication, pharmaceuticals, medical service etc. The impact on tourism, automotive, constructions, manufacturing including textiles & garments will last over one year or so, whereas education, aviation, banking & commercial services and transport will recover in a short period of time, hopefully within three months. This will be reflected in the share prices as well.

The textile and garment industry in Sri Lanka recorded USD 5.6 billion in export earnings in 2019 and the estimated losses for the 3-month period from 15th March to 15th May round up to USD 1,400 million.

Remedies

- In the short-term, the government has to provide additional support for businesses to help smooth the impact of the COVID-19 on their core business. The debt moratorium for interest and capital payments tax concessions will ease financial pressures on businesses. However, the government should not weaken the liquidity levels of banking institutions which are well performing in the stock market in its attempt to give concessions to other affected industries.
- Promotional campaigns will help raise international awareness and investor interest in Sri Lanka's stock market. The government has already started this not to promote the stock market but to sustain the sovereign credit rate without falling to CCC+.

4.4 Textile and garment sector

Despite the Easter Sunday Attacks, the earnings from industrial exports, which accounted for approximately 79% of the total export earnings, increased USD 9,426 million in 2019 from USD 9,258 million in 2018, mainly supported by the growth in textiles and garments exports. Being the largest contributor, the earnings from textiles and garments increased by 5.2% to USD 5,596 million in 2019.

Earnings from garment exports to the USA increased by 3.0% to USD 2,338 million in 2019. Garment exports to the EU also increased by 4.9% to USD 2,153 million, stimulated by the regaining GSP+ concessions, while the UK, the second-largest single buyer of Sri Lankan garments accounted for USD 747 million. Furthermore, Italy, Belgium, Germany, and the Netherlands in the EU as well as Australia, Canada, Japan, and India were among the uppermost buyers of Sri Lankan garments before the COVID-19 outbreak.

Revenue loss

- The impact of the COVID-19 on the textile and garment industry in Sri Lanka is unprecedented, and second to none on both the demand and the supply sides. The industry recorded USD 5.6 billion in export earnings in 2019. Assuming export earnings are equally distributed throughout the year, the estimated losses for the 3-month period from

15th March to 15th May round up to USD 1,400 million, and the situation is unlikely to achieve or reach near the annual target of 2019, totalling to USD 5.6 billion exports.

- The Joint Apparel Association Forum (JAAF) foresees an immediate contraction of USD 1.5 billion in Sri Lankan apparel exports during the 3-month period ending in June, as against the last fiscal year. However, further demand contractions could result in a reduction of apparel exports by an additional 30 – 40% after June, due to mass cancellation of orders by buyers and problems in the purchasing of necessary raw materials. These circumstances, coupled with delayed shipments, forced discounts, and currency depreciation, have led to working capital problems across the industry. The suppliers usually commence production 4 - 6 months ahead of the product reaching the export destinations. Some cancellations even relate to products that were put into production in January. Some products, while being ready for shipments, have been cancelled or have not been shipped because of the lockdown. This will cause revenue losses running to the 3rd quarter of the year as well.
- Delays in production due to lockdown caused further cancelation of orders, which shifted to countries such as Vietnam, Cambodia, and Indonesia, which were completely operational.

Mass cancellation of orders by buyers and problems in the purchasing of necessary raw materials, coupled with delayed shipments, forced discounts, and currency depreciation, have led to working capital problems across the industry.

Demand-side

- The market for Sri Lanka's textiles and garments concentrates on the USA, UK, and EU countries. Figure 3.6 shows the concentration of Sri Lanka's textiles and garments market. The most alarming signal is that 45% of the Sri Lankan export market depends on the USA, which is the most COVID-19-affected country in the world, followed by UK (14%), Italy (8%), Germany (6%), the second most severely the COVID-19-hit countries. (see Figure 4.6) These four countries alone share 73% of the entire export market, meaning that Sri Lanka's textiles and garment markets are severely threatened by demand constrictions. Other non-EU buyers like India, Australia, and Japan are also under threat. Therefore, the manufacturers have to expect more and more cancelation/delaying of orders they currently have in hand.

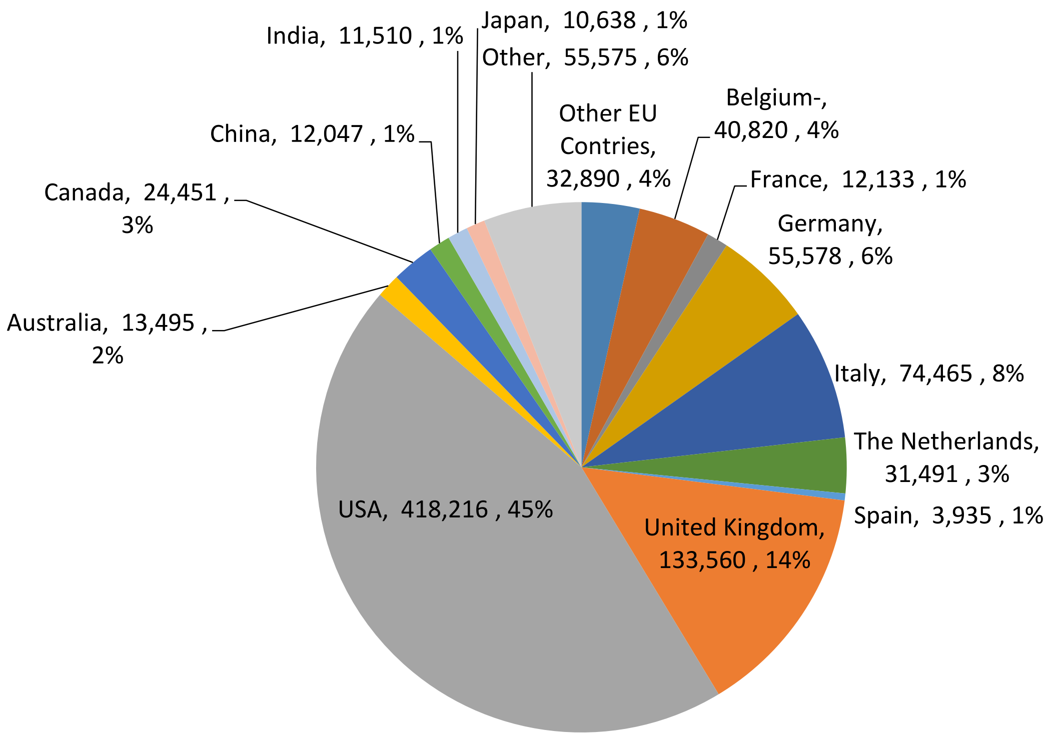


Figure 4.6: Percentage share of export destinations for the textile and garment industry of Sri Lanka, 2019

Supply-side

- The Textiles and Garment industry in Sri Lanka comprises some 850 factories of which approximately 26% are small-scale industries. Fifty-one per cent are medium-scale industries and the remaining 23% fall in the category of large-scale industries. One hundred twenty-six factories are located in the 12 Export Processing and Industrial Zones.

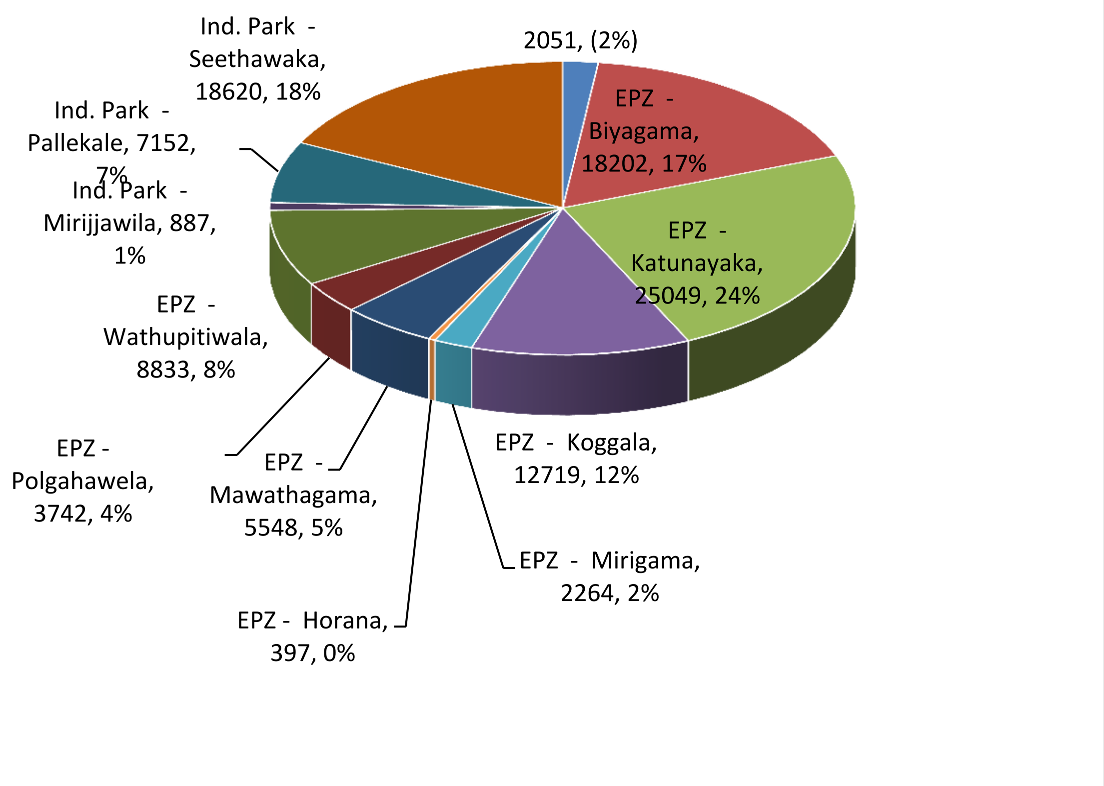
Table 4.2 : Number of garment factories and employment in export processing and industrial zones in Sri Lanka, 2020

Industrial Zone	Number of factories	Employment
EPZ - Malwatta	4	2,051
EPZ - Biyagama	23	18,202
EPZ - Katunayaka	36	25,049
EPZ - Koggala	15	12,719
EPZ - Mirigama	1	2,264
EPZ - Horana	2	397
EPZ - Mawathagama	5	5,548
EPZ - Polgahawela	4	3,742
EPZ - Wathupitiwala	10	8,833
Ind. Park - Mirijjawila	2	887
Ind. Park - Pallekale	7	7,152
Ind. Park - Seethawaka	17	18,620
Total	**126**	**105,464**

Source BOI Statistics

- According to the Sri Lanka Labour force survey 2019Q4, the total employment of Sri Lanka is 8,181,442 out of which nearly 20%, i.e. 400,000 workers, are currently employed in the textiles and garment industry. Also, the industry provides home to more than 2 million indirect beneficiaries. As depicted in Table 4.2, approximately 105,400 workers are employed, in the 12 export processing and industrial zones. Complete shutdown and working with 1/3 of the labour force caused a loss of at least 16 million labour hours per month in the export processing and industrial zones alone. The majority of the firms in the industry will struggle to pay salaries from the end of April onwards with certain amounts of pay cuts, and a considerable portion of temporary workers losing jobs are inevitable. This would result in underutilization of installed capacity even after reopening the economy.

Approximately 105,000 workers are employed, 12 in the export processing and industrial zones. Complete shutdown and working with 1/3 of the labour force caused a loss of at least 16 million labour hours per month in the export processing and industrial zones alone.



In some garment factories workers are now only paid the basic salary. Moreover, in the name of making up for lost time, (182 hours during national lockdown) they have to work an extra hour per day without additional pay.

Figure 4.7: Employment in the textiles and garment industry, 2020, by industrial zones

- In some factories workers are now only paid the basic salary. Moreover, in the name of making up for lost time, (182 hours during national lockdown) they have to work an extra hour per day without additional pay. All allowances, including the attendance allowance, have been cut and the New Year bonus was not paid. Brandix, which employs 47,000 workers, has cut wages by between 5 and 30%, gutted welfare allowances and sacked temporary workers (Wsws.org, 16 May 2020). On May 20, about 450 workers from the Everbest garment factory at Yakkala, protested against company attacks on jobs and wages. Owing to the financial crisis workers in many factories would only receive half their monthly wages in May. It is reported that some companies have informed workers that they could “voluntarily retire”.
- There is also a threat that some multinational companies might leave Sri Lanka for cheap labour in the near future using the COVID-19 shock as an exit point. Hirdaramani, a well-established manufacturer in Sri Lanka, recently opened a new plant in Ethiopia where monthly salaries are only USD30.

- The COVID-19 threat in China has threatened Sri Lanka's apparel industry with 50 factories or more pushing to temporary closure due to the uncertainty prevailing over the supplies of raw materials to factories from China. Most of the raw materials such as fabric, and accessories such as zippers and labels are imported from China. Sri Lanka currently imports nearly 25% of its fabric needs from China. In 2018, Sri Lanka imported cotton worth the USD 218.1 million and knitted/crocheted fabric worth USD 132.6 million from China. The apparel sector imports most of its raw materials from China. The collapse in supply chains due to the COVID-19 following the Chinese New Year has halted raw material production lines for the apparel sector. Although China claims that it is back to normal the Chinese raw material manufacturers are still struggling with limited labour supplies, and cannot meet the world demand.

Remedial measures

Recovery in the world market is beyond our control. The following remedial measures are recommended to sustain the supply side until the international markets reinstate.

1. To reopen factories having pending orders in hand, subject to health directions, as early as possible at their full capacity. Otherwise further trade shifts may take place in favour of competitors like Bangladesh, Cambodia, Vietnam, and Indonesia.
2. To explore new markets in play, including those related to new products currently in demand in Europe and North America.
3. Government approval to extend overtime (OT) hours from legally permitted 60 hours to 90 hours for the 3 months beginning from June for the benefit of factories having overdue orders in hand.
4. To grant adequate loan facilities subject to the Credit Support Scheme referred by the Central Bank Circular No.4 of 2020 dated 24th March 2020 to ensure the working capital finance of SMEs. According to the circular, SMEs are eligible to receive a six-month debt moratorium and working capital finance at 4% interest for at least 6 months backed by refinance.

There is also a threat that some multinational companies might leave Sri Lanka for cheap labour in the near future using the COVID-19 shock as an exit point.

5. In presence of an approximately LKR 650 billion revenue loss due to tax cuts introduced following the Presidential election last year, as well as the delays in revenue collection during the pandemic, it will create a significant fiscal burden for the government alone to implement such stimulus packages. Thus it will be essential to issue directions to the commercial banks to grant loan facilities sufficient to pay a minimum of two month's basic salary for the SMEs without collateral but under the refinancing scheme of the government.
6. To suspend of EPF/ETF deduction from employers for 6 months as a temporary relief to maintain liquidity.

In presence of an approximately LKR650 billion revenue loss due to tax cuts introduced following the Presidential election last year, as well as the delays in revenue collection during the pandemic, it will create a significant fiscal burden.

4.5 Construction sector

The construction sector was one of the front-runners in the Sri Lankan economy during the post-war era. The data speak for themselves to prove the prominent contribution made by the construction sector for the GDP growth of the country while many other sectors failed to maintain consistent growth.

The industrial sector is the second-largest contributor to the GDP of the country after the services sector. Within the industrial sector, the construction sector is the second largest contributor where the manufacturing sector is responsible for the lion share. To put this into perspective, during last year (2019) the service sector contributed to 57.4% of the GDP whereas the industry and agriculture sector contributed 26.4% and 7% respectively.

Within the industrial sector, the manufacturing sector's contribution was 15.6%, whereas the construction sector contributed 69% to GDP during the same year. According to our calculations, the construction sector's contribution to the GDP on average was 7% during the last six years. Also, despite the abrupt disruptions due to the Easter Sunday attacks last year, the construction sector was able to maintain the growth momentum.

In terms of employment generation, the construction sector is vital as it has been the destination of many unskilled labour force participants of the country. According to the annual construction sector survey published by the Department of Census and Statistics, there are around 95,000 people who had to find their livelihood from the construction sector.

The economic importance of the construction is not limited to the sector itself. The operational arrangement of the construction sector is also supporting the functioning of the other economic activities. The construction activities are bound with other economic sectors through their forward and backward linkages within the industry sector such as manufacturing and mining and quarrying activities. In addition, it also relates to other sectors such as the service sector that supports trade and financial services. Thus, any adverse development in the construction sector will generate adverse multiplier effects on the economy through various channels.

Based on this backdrop, this section is dedicated to understanding the impact of the on-going pandemic on the construction sector. In order to make inferences, in-depth interviews were conducted with industry experts to derive an idea about the current position of the construction industry and possible mitigation methods to deal with the issues arising due to the pandemic situation. In addition, secondary data has also complied with the Central Bank annual reports and the Department of Census and Statistics.

The current situation of the construction industry

The facts presented in this segment are primarily from the interviews had with the stakeholders and the facts were supported with secondary data wherever necessary. As per the information gathered from the interviews the challenges faced by the construction sector due to the ongoing pandemic can be categorized into four segments as discussed below.

Human resource and labour-related challenges

With the imposition of the curfew to prevent the community spread of the virus all construction activities were suspended. However, at the time of the preparation of this report, many construction projects in the country are in the process of reopening. Unlike many other professions, working from home is not applicable to construction activities other than the administrative work.

The physical presence of the workers in at the construction site has become challenging. Even though large-scale operators are not directly engaged in raw labour-related matters as they employ them through sub-contractors, a significant proportion of the construction companies in the country are not large-scale operators. Thus, they

According to the annual construction sector survey of the Department of Census and Statistics, around 95,000 people find their livelihood from the construction sector.

are struggling to get back many of their labourers to work. This situation is comparatively extensive in construction projects located in the Colombo district where the majority of workers are from the rural parts of the country.

In addition, in line with government directions and the direction issued by the respective companies the labour utilization in ongoing construction projects has to reduce to meet health directions. In some cases, the requirement is up to 25% of the previously employed construction workers. However, one common issue that arises due to this direction is that many construction workers are specializing in given tasks of the entire construction. Thus, limiting numbers may constrain the healthy function of construction activities.

Ensuring social distancing and undertaking certain activities are challenging and have affected services such as providing foods and accommodation facilities.

In meeting the issued health safety guidance there are challenges for the construction sector due to the structural arrangements of the construction projects. Ensuring social distancing and undertaking activities have become challenges and this is especially affected by aspects such as providing foods and accommodation facilities. While this is costly for the companies to meet the given guidelines they accepted to follow the guidelines given by health officials.

However, these labour-related challenges are presented here with the perspective of the construction companies. From an economist's point of view, the majority of workers are daily wage earners and may not have enough savings to effectively absorb this type of economic shock for months. Thus, their vulnerability to falling into poverty is very high.

Raw materials

As it is with the labour the raw materials are also important elements for the proper functioning of the construction sector. As per the views presented by industry experts for ongoing construction projects, the availability of the raw materials would not be much of a challenge as they have been purchased in advance. However, with rising manufacturing costs, exchange rate depreciation and restrictions on imports, there will be an upward adjustment of prices for many of the construction materials. Thus, it will ultimately affect the overall construction cost in the future.

Financial difficulties

Even before the island was affected by the pandemic, the construction sector was affected by the cash flow constraints put forward by the delayed payments for government-funded construction projects. Also, even some privately funded projects are not in place to fully pay back the initial investment at this point in time. Respondents were worried that this would affect the consistent growth of the construction industry in the years to come. Thus, maintaining cash flow has become a challenge to the construction sector. This has also affected the ability to repay loans that they obtained to fund these projects as well.

The majority of the interviewees also admitted that they could understand the difficulty for the government to pay their deeds at this point in time (focus group discussions, 2020). However, in order to put the Sri Lankan economy back on track, the government's supporting hand is vital even for these well-performing sectors.

Within the construction industry, the condominium development projects are given special concentration as they were one of the main components of the private sector investment in construction projects. Many high-end condominium projects were facing dry markets even before the pandemic. However, the respondents had mixed responses regarding the future of the demand expectations on the condominium developments in the country. While admitting that the already-completed projects cannot be offered at a lower rate as they have already incurred the cost, some respondents were pessimistic about the future demand of condominiums. Despite all these negative influences, some respondents were optimistic about the future of the condominium sector. According to them, based on the way that the country responded to the pandemic and the returning of Sri Lankans who were living abroad, would generate a positive impact on the at present dry market.

Many high-end condominium projects were facing dry markets even before the pandemic.

Reaching contractual agreements

Almost all respondents were concerned about meeting the contractual agreements on completion dates and the pre-estimated costs of the ongoing projects. Admitting the delays of construction due to curfew, they also noted that there would be issues in the coming months. Working with fewer employees would also generate constraints to meet the deadlines. On the other hand, as the cost is expected to raise the pre-estimated costs needs to be adjusted accordingly, they further elaborated.

Policy options

Upon examining the challenges, the next section looks at possible policy directions to deal with these challenges. Labour-related issues can adhere to the involvement of the government in a way of issuing a license or any other means for workers to reach their working sites. On the other hand, if a second wave does not emerge in the country, the restriction on human mobility will be gradually released. In the medium run in site health inspection facilities would be beneficial in large-scale construction projects to ensure a safe working environment. Also, the majority of small scale operators should also be looked after with financial support. The cash flow-related issues should be handled as soon as possible to ensure healthy operations; especially the delayed payments for government-funded projects should also be looked after with a formal budget passed in the parliament for the better functioning of the sector.

The cash flow-related issues should be handled as soon as possible to ensure healthy operations; especially the delayed payments for government-funded projects should also be looked after.

4.6 Retail and consumer goods market

Around the world as well as in Sri Lanka, many markets are now planning their exit strategies from living restrictions implemented to flatten the curve of the COVID-19. Each government is preparing its own pathway to “a new normal,” complete with restrictions, health-safety protocol and changed consumer behaviours, in hopes of restarting the economy while still keeping the virus under control.

The contribution to the GDP from the sector of retail and consumer goods is approximately 34%, while it contributes emplacement generation by 14%. Therefore, the retail and consumer goods sector is also playing a vital role in the economic development of Sri Lanka. As a consequence, in the years 2016 and 2017 Sri Lanka was ranked 12th in the Global Retail Development Index (GDRI) among 30 countries, for potential in retail investment and growth (DailyFT, Jul 30, 2020).

The retail and consumer goods sector is one of the most affected sub-sectors of the service sector in Sri Lanka. Due to the COVID-19, most corporations expect a recession in 2020 as well as a negative revenue impact.

As unemployment levels of Sri Lanka increase, and economic and business forecasts plunge, two types of consumers are emerging. Firstly, there are those relatively unaffected from income loss who have similar or even more discretionary income, then there is a second group of consumers who have had their income and spending significantly constrained due to unemployment, furloughing or other COVID-19-related challenges.

According to current data, demand for non-essential goods and services will be severely hit in 2020, given the economic impact of strict social distancing requirements. Even sales of essential items may suffer from supply-chain disruptions.

Based on the survey data, the following points can be highlighted on the Sri Lankan retail and consumer goods industry after the COVID-19 pandemic:

- The sales volumes of large-scale institutions were dropped by 35% - 50% in March and April while medium and small-scale sales volume rose by 40% in April compared with last year.
- Several large-scale institutions were trying to lower the operational cost and were able to remain only on a 25% profit lost.
- As the working from home concept worked only with 50% of the staff, the production capacity of the total industry dropped by 50%.
- As the debtors failed to pay back to the companies, there is a loss of working capital for reinvestments. As the continued effect of this issue, the production process of consumer goods industry will be damaged.
- Since there will be a lack of imported items, the supply chains of the industry are at risk.
- The total volume demanded by the hotel industry has now totally dropped and this will lead to a profit loss in the consumer goods industry.
- The buying patterns of the consumers are in a changing trend owing to the income loss of consumers and unsettled mindsets. This will sharply affect the consumer goods industry on a negative aspect.

As a quick solution for these impacts, several trading firms have already activated several strategies like the "direct to customer" process and online promotion steps.

As the debtors failed to pay back to the companies, there is a loss of working capital for reinvestments.

The corporate sector needs to focus on changing consumer behaviours and life-style patterns and develop new marketing plans, including a stronger emphasis on online trading.

Recommendations to the government and trading firms

Short-term strategies

- Strengthen the cash flows of trading firms through working capital loans.
- The corporate sector needs to focus on changing consumer behaviours and life-style patterns and develop new marketing plans, including a stronger emphasis on online trading.
- Trading firms should look at cost saving measures in every aspect of the value chain.
- Focus on the "direct to customer" concept.

Medium and long-term strategies

- Increase circulating money stock through interest rates to attract customers to supermarkets.
- Continuing the ease of cost pressure through tax reliefs that have been already granted from Dec.2019 (Income tax, VAT, PAYEE).
- Strengthen the working capital and reinvestment through a business loan scheme.
- Encourage import substitutions.

4.7 Private sector trade chambers involvement

The prevailing COVID-19 pandemic affects Sri Lanka along with the rest of the world through numerous channels. Amongst health effects, sharp declines in domestic demand, lower tourism and business travel and disruptions in trade, production and supply chain linkage have also taken place.

Though Sri Lanka has taken extra-ordinary measures to minimize the impact on human lives, the disruption to the society and the economy is unprecedented. Rather than focusing on a single sector, it is vital to consider a range of sectors/chambers under the umbrella of the Ceylon Chamber of Commerce.

> "According to a recent survey conducted by the Ceylon Chamber's Economic Intelligence Unit (EIU), 49% of its member organizations have been impacted by the new

Coronavirus, the COVID-19). The survey focused on the impact the virus had on businesses in Sri Lanka" (economy.lk).

Although the pandemic has spread to all parts of the world and affected every sector of the country, measuring of its economic impact on businesses is difficult. However, the Sri Lankan economy marked the lowest growth in 18 years in 2019, with 2.3% as a result of the Easter Sunday attacks. The prevailing COVID-19 outbreak has added more challenges to the growth outlook, with symptoms of a contraction in 2020. Meanwhile, the CBSL expects a 1.5% growth for 2020. Despite the relief package of lower oil prices decreasing the trend of tourism, exports and remittances are headed to widen the current account deficit to the GDP in 2020 (CBSL, 2019). Rising macroeconomic instability among the prolonged policy uncertainty due to postponed parliamentary elections and rising public and external debt sustainability challenges made fragility in business

All economic sectors are affected by the pandemic despite its scale. All export sectors are struggling with few exemptions linked to exports that can cater to export of Personal Protective Equipment (PPE).

All export sectors are struggling with few exemptions linked to exports that can cater to export of Personal Protective Equipment (PPE).

In order to identify the gravity of the pandemic in the apparel industry, the loss in export revenue was 41% in March and 82% in April 2020, with a USD 750 million turnover lost in just a matter of 2 months. Though the 3rd highest foreign exchange earner and the 2nd highest net Forex earner, tourism industry recorded zero earning in April 2020. Since tourism also has a large trickle-down effect the impacts are much greater than what is seen on a surface level.

Consideration into the implications of the COVID-19 situation for Sri Lankan business supply chains and markets mainly focused on sourcing of raw material for domestic and export processing production were severely impacted. Especially on firms which ran on a just- in- time inventory system. Furthermore, cost structures have also changed as some firms had to source raw materials from alternative sources amid the prevailing pandemic situation.

Key export markets of Sri Lanka (US and EU) and import markets (China, India) are in stressed conditions due to the COVID- 19 impact. The pandemic has also caused countries to change their investment strategies. Similar to the investment diversions that took place as a result of the trade war between the US and China, now countries are looking to invest in new locations and businesses to minimize risk that arises out of situations such as the COVID-19 and natural disasters.

The Ceylon Chamber of Commerce recommendations form the foundation of a synergistic private and public sector partnership focused on achieving accelerated economic repossession in the post-COVID-19 context.

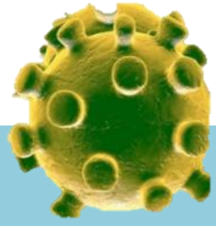
Especially, they have focused on establishing a foundation for accelerated recovery and wider adoption across the private sector in Sri Lanka.

Recommendations for wider adoption across the private sector in Sri Lanka:

Configuration to the Principle of Primacy for the maintenance of livelihoods by applying innovative measures with respect to adjustment of production and service portfolios to meet adjacent demand in the context of crisis and post-crisis environments will result in employment retention and creation. Besides, retraining and redeployment of employees towards productive and value addition tasks and vocations along with the compromise of employment to be limited to a measure of last resort will be effective. Re-engineering of supply and value chains with pre-eminence for domestic supply eco-systems, central to which will be SME capacity building and financial support, where viable. Activation of enterprise supply chains by adopting aggressive negotiation measures with foreign suppliers while assisting the Government of Sri Lanka in overcoming Sri Lanka's foreign exchange liquidity constraints will secure preferential credit terms which extend beyond the immediate post-COVID-19 period.

The Ceylon Chamber of Commerce recommendations form the foundation of a synergistic private and public sector partnership focused on achieving accelerated economic repossession in the post-COVID-19 context.

Active participation in extending private sector capacity in logistics, fulfilment and supply chain infrastructure for the use of the public sector will lead to bridge supply, demand and storage asymmetries across the agriculture, livestock and fisheries sectors. Fast-track the digitalization of operations as well as the interfaces to suppliers, partners and domestic customers are essential. Implementation of agile employment technologies and interfaces to enable the engagement of casual employees and daily workers within adjusted



work profiles and value chains, active promotion of ‘work from home’ (WFH) practices will be beneficial.

Meanwhile, “Black Swan” events such as environmental, economic, political, societal, or technological in nature are almost impossible to predict and often bring massive repercussions. In the case of the COVID-19 occurrence, traditional economic management strategies, crisis management strategies and health management strategies are crippled and often fail in their delivery capacity to tackle this.

Henceforth, we, as a nation, should shift into a new normal and cater to the demand during new normal and public policies need to be amended and the regulatory environment needs to change to facilitate new normal environments.

The following examples provide the possibilities in different economic sectors.

- The IT-BPO sector will have to proactively look for opportunities to cater to digitization demand.
- Tourism will open new doors as new travel corridors/bubbles form and more emphasis is made on wellness tourism.

Historically, times of crisis have also been provided opportunities for change. In the context of the COVID-19 structural re-engineering, digitalization and transformation of key sectors are important. Hence, the government of Sri Lanka reassure and incentivize structural changes in the sectors of Education, The public sector, SOE re-engineering & PPPs, Workforce & labour, Targeted & inclusive welfare, Energy, Capital markets and the Transportation sector.

Ensuring sufficient diversification and guidance on businesses and diversifying across businesses will protect the business entrepreneurs from greater losses and drive their business into sustainability amidst the COVID-19 pandemic.

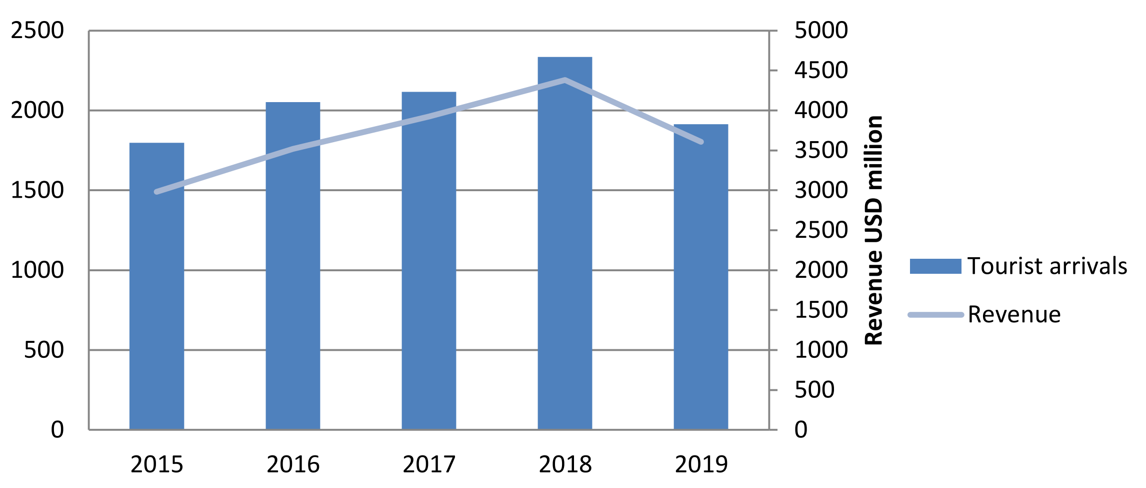
Henceforth, we, as a nation, should shift into a new normal and cater to the demand during new normal and public policies need to be amended and the regulatory environment needs to change to facilitate new normal environments.

4.8 Travel and tourism in Sri Lanka

Sri Lanka Tourism at a glance before the COVID-19

Tourism has become one of the highly significant services sectors and has been an engine of economic growth in Sri Lanka. Travel and tourism contributed to the GDP of the country by 12.5% in 2018. The tourism sector plays a significant role in the Sri Lankan Economy where it has reached the third position in its contribution to foreign exchange earnings. The contribution amounted to 15.9% in 2018 (SLTDA, 2018). The total earnings of USD 4.4 billion in 2018 declined to USD 3.7 billion in 2019 (SLTDA, 2020) demonstrating the worst hit among other top foreign exchange earners.

Though tourism continued to report a two-digit growth rate at the end of the civil war, the growth rate has collapsed due to the Easter Sunday attacks in 2019, causing a USD 1.5 billion loss in tourism revenue (see Figure 3.10). However, Sri Lanka's tourism regained portraying an unexpected growth of arrivals due to the collective effort by the government, security forces, the Sri Lanka Tourism Development Authority (SLTDA), and the Sri Lanka Tourism Promotional Bureau (SLTPB).



Source: SLTDA

Figure 4.8: Tourist arrivals and earnings from tourism 2015-2019

Tourist arrivals from all major regions declined in 2019. Europe, continued to be the largest tourist origin for Sri Lanka, reported a decline by 12.8% in 2019, in comparison to 2018. Figure 4.8 illustrates the changing pattern of tourist arrivals as well as the revenue from tourism over the last five years. The continuous increase in both arrivals and revenue has shown a decline in 2019 due to the impact of the Easter Sunday attacks.

The tourism industry continued to attract a significant investment in 2019 despite the setback in tourist arrivals as a result of the Easter Sunday attacks. The Investor Relations Unit (IRU) of SLTDA has granted approval for 59 hotel projects in 2019 to add 2,237 hotel rooms to the existing capacity. Furthermore, new proposals worth US dollars 189 million for 132 hotels were referred to the IRU in 2019 in order to improve the accommodation capacity by a further 2,584 rooms in the industry (CBSL, 2019).

Several policy measures and numerous promotional campaigns were implemented in 2019 to enhance the potential of Sri Lanka's tourism industry with special activities such as relief packages and a debt moratorium for stakeholders in tourism. Furthermore,, the SLTPB carried out 59 travel and tourism fairs and 18 road shows giving opportunities to local travel organizations to create direct business relationships (CBSL, 2019). The COVID-19 outbreak severely affected the industry while many parties were resilient to the Easter Sunday attacks.

The Effect of the COVID-19 on Sri Lanka's Tourism

> "Tourism has been hit hard, with millions of jobs at risk in one of the most labour-intensive sectors of the economy" UNWTO (2020).

According to the provisional estimates of UNWTO, a loss of 67 million international arrivals and about USD 80 billion in receipts is expected all over the world. The UNWTO further exemplifies that Asia and the Pacific is at the highest risk with a loss of 33 million arrivals. Sri Lanka, as an Asian destination, was hit hard by the COVID-19 pandemic.

The COVID-19 outbreak and the Easter Sunday attacks have shown that the tourism and hospitality industry is vulnerable to external and internal shocks. Due to the worst condition of the COVID-19, all tourism-related industries, businesses and individuals are experiencing zero revenue without any hope for the next 2 - 3 quarters.

The COVID-19 outbreak and the Easter Sunday attacks have shown that the tourism and hospitality industry is vulnerable to external and internal shocks.

The COVID-19 outbreak severely attacked the tourism industry while many parties were resilient to the Easter Sunday attacks.

Table 4.3: Monthly tourist arrivals to Sri Lanka from January 2019 to March 2020

Month	2019	2020*	% Cha. 2019/20
January	244,239	228,434	(6.5)
February	252,033	207,507	(17.7)
March	244,328	71,370	(70.8)
April	166,975	---	---
May	37,802		
June	63,072		
July	115,701		
August	143,587		
September	108,575		
October	118,743		
November	176,984		
December	241,663		

Source: SLTDA

As Table 4.3 illustrates, tourist arrivals declined rapidly from January 2020 to April 2020. Consequently, there were no arrivals at all in April since the Sri Lankan government decided to close down the all channels of tourist arrivals while travel bans were imposed on all source markets, as well. Travel bans, suspension of flights and curfew regulations have very much affected the tourism sector not only Sri Lanka but the many other countries also. According to ADB estimates, until March 2020, the decline in tourism revenues for Sri Lanka could range from USD 107 million to USD 319 million. However, during April 2020 there was a loss of total income from tourism since the arrivals dropped to zero. It was around USD 29 million for the month of April.

Tourism significantly contributes to labour force participation directly and indirectly. Total employment was around 5% of total labour force participation in Sri Lanka in 2019 (author calculations). Almost all these employees are vulnerable to the COVID-19 outbreak. The COVID-19 impact severely affected the livelihood of both types of employees. Almost all the investors are currently experiencing zero income due to the COVID-19 outbreak while they are maintaining their permanent employees paying just their basic salaries. Entire contract basis employees have lost their jobs in the sector and it is around 95%. The livelihood of indirect employees such as retail sellers, tour guides, safari drivers was totally lost due to the COVID-19 and some of the tourism establishments already laid off their temporary and casual staff. Salary freeze was introduced and is continuing while some other organizations started to reduce the salary at different percentages (TD1).

According to the information revealed by discussants, approximately 20% of direct employees will lose their jobs in the post-COVID-19 period and will not be able to find new jobs under the current situation in the country. Therefore, these individuals are the most vulnerable to the COVID-19 impact (TD1). The situation will worsen further since the hoteliers and destination management companies have warned that they will have to lay off a considerable number of staff if the COVID-19 pandemic continues.

All the national parks have been closed since March 2020, up to the final date of the researcher's discussions. Tour guides, jeep drivers, guesthouse owners, and many others who are dependent on tourism for their livelihood have been severely affected due to the COVID-19 outbreak and the per day loss of the tip value is around LKR750 other than the regular salary (TD5). Loss of the income for guesthouse owners cannot be calculated exactly by a sample, since it depends on the many factors such as number of beds occupied, seasonal effects.

Women who are attached indirectly to the tourism sector are the most vulnerable in the industry's workforce in Sri Lanka. As revealed by the informants, tourism is labour-intensive as pointed out by the UNWTO and a leading part of the workforce in Sri Lanka is the young people and amounts to over 70% of the workforce (TD1&2) and their livelihood is hit hard by the COVID-19.

The Government of Sri Lanka considers tourism as a key sector of the economy and thus, has planned USD 7 billion of the income with 4 million tourist arrivals and has planned to upgrade 75,000 graded accommodation capacities (BOI, 2019). Following the investment policy and the strategic plan of the SLTDA and the Sri Lankan government, a huge investment has made giving special reference to accommodation through bank loans. However, even though the government has given a concession for repaying loans, investors of travel and tourism are in financial distress with zero income and no

Direct and indirect employment in tourism sector is approximately 5% of total labour force participation in Sri Lanka. Almost all these employees are vulnerable to the COVID-19 outbreak. The COVID-19 impact severely affected the livelihood of both types of employees.

hope for a further six to nine-months' period for their income (TD1&3). Some of the investors are reluctant to go ahead with these concessions and are ready to foreclose the mortgages and close down the business due to the existing circumstances. The biggest challenge that investors are facing under the current crisis is that lenders (particularly the banks that provided huge loans for investment) are rejecting the foreclosing of mortgages since banks are also in danger (TD1).

Following the investment policy and the strategic plan of the SLTDA and the Sri Lankan government, a huge investment has made giving special reference to accommodation through bank loans. The investors of travel and tourism are in financial distress with zero income and no hope for a further six to nine months' period for their income (TD1&3).

Accommodation providers have cut down all promotion campaigns and online bookings reached zero. It is impossible for businesses in the tourism sector to recover on their own (TD2). In this context, investors are seeking more flexible remedies from the government and banks to protect the industry and the livelihood of the individuals who are attached to tourism directly and indirectly (TD2).

According to the stakeholders it is not possible to expect a growth in the tourism industry for the next 2 - 3 quarters. This may be due to air travel restrictions and mainly the need for maintaining social distancing and other health precautions. Stakeholders believe that it will take two more years to experience normal conditions since the COVID-19 has no vaccine invented yet and a second wave is expected from other countries. Social distancing and health precautions will remain the current situation for a further one year if the second wave of the COVID-19 does not emerge (TD3&4).

Though some of the employees were eligible for government subsidies, small-scale stakeholders are finding it hard to earn enough to recover their investments. For example, safari jeep owners would like to sell their vehicles since there is no immediate hope about the industry, but this is not possible because safari jeeps cannot be utilized for any purpose other than the planned activity (TD4 & 5). Most of the jeep services are financed through leasing facilities and thus, the owners are struggling to pay the instalments due to loss of income. These stakeholders are not satisfied with the remedies given by the government in terms of loan moratorium and they are expecting more flexible repayment schemes which are adjustable regarding the potential growth of the industry (TD5&6).

Almost all the individuals from labourer to five-star hotel owners have been severely affected by the COVID-19 outbreak and the impact is much higher than any other economic sectors due to the perishable nature of the industry.

The president's dream of attracting six million tourists by 2025 and earning USD 10 billion in income is dubious due to the COVID-19 impact and furthermore, the target of achieving 3.5 - 4 million tourists and earning USD 5 billion in 2020 has a very low probability of success with the rapid the COVID-19 outbreak around the world.

Challenges and the way forward

It is not possible to recover the tourism sector in a country on its own but with all other countries collectively. As a popular tourist destination, Sri Lanka can achieve this, however it needs its own new travel and tourism strategies and policies. The policies should provide protection to both stakeholders involved in the tourism industry and visitors. Stakeholders need protection for their financial distress while visitors must be protected in terms of health conditions.

Safari jeep owners would like to sell their vehicles since there is no immediate hope about the industry, but this is not possible because safari jeeps cannot be utilized for any purpose other than the planned activity.

The stakeholders who invested in tourism in terms of lands, hotels, restaurants and vehicles are in a financial crisis and are in a hazard in terms loan repayment and payment of salaries for permanent employees. The government has already declared some defensive activities such as issuing of a debt moratorium on capital and interest payments on debts. Investors are not satisfied with the existing provisions and are in quest of somewhat flexible responses from the government and banks. Furthermore, there is no guarantee for the period of loan moratoriums. Therefore, there should be a financial strategic plan for both parties and flexible discussions and close consultations are required before the strategic planning for recovering the pain of loan repayments. Thus, the first effort should be to retain the existing investors in the industry, rather than attempting to attract new investments.

According to past experience, foreign travellers are highly safety-sensitive. The burgeoning of tourism after the Easter Sunday attacks was clearly due to the provision of the safety brand of the country. Similarly, individual travellers will expect to know about Sri Lanka's COVID-19 safety status after reopening the country for foreign visitors. Thus, the government of Sri Lanka needs to play a vital role in establishing a trustworthy COVID-19 safety statement regarding travel and tourism. Therefore, quick and effective risk management protocols are required to establish in terms of restoring visitor confidence that Sri Lanka is safe and in a normal condition as a destination for foreign visitors. Authorities will be able to handle social media in this context. This endeavour further helps to recover the other important sectors of the economy affected by the COVID-19. The entry restrictions for some source countries who are experiencing more vulnerable conditions of the COVID-19, a quarantine process for visitors and changes on visa issuing processes for foreign travellers- example; automated visa issuing technology, could be introduced.

There are substantial positive and negative effects of “word of mouth” in tourism. Therefore, the government of Sri Lanka must initiate a suitable mechanism to absorb the positive effects of word of mouth of the early post-COVID-19 visitors to Sri Lanka.

One of the foremost challenges to Sri Lanka will be the destination competition within the South Asian region. At the other end, travellers will seek low-budget travel plans. Therefore, Sri Lanka’s tourism will have to offer considerably low-budget plans in their promotions, compared to other Asian countries. Hotels and other travel and tourism-related organizations will have to operate on their Break-Even point in their businesses at the beginning of new era after the COVID-19 and gradually increase the profit margin. In this process the, Sri Lankan government has to take care of all the travel and tourism-related organizations providing necessary subsidies with a long-term plan to recover the industry.

The first effort should be to retain the existing investors in the industry, rather than attempting to attract new investments.

It is believed that resuming probability of business travel will be higher than leisure travel after a crisis and thus, business travel improvement must be in the priority in policy-makers’ agenda and government intervention may be highly effective in this endeavour.

Many countries regulate the tourism industry introducing new policies and strategies for travel and tourism. Therefore, Sri Lanka cannot expect as many visitors from its source markets as before. The promotion of domestic tourism will be a valuable alternative for regaining the industry since domestic demand is expected to recover sooner than international demand, according to the UNWTO Panel of Experts survey.

Policy-makers are advised to follow up the UNWTO recommendations since Sri Lanka, as a destination, depends on the European market, as well. The UNWTO presented three different scenarios based on the removal of travel bans and then lockdown situation and opening of borders in source markets. Figure 4.9

illustrates these scenarios. Accordingly, the travel and tourism sector will start breathing in the second and third quarters of 2020, and most probably, will be normal in 2021.

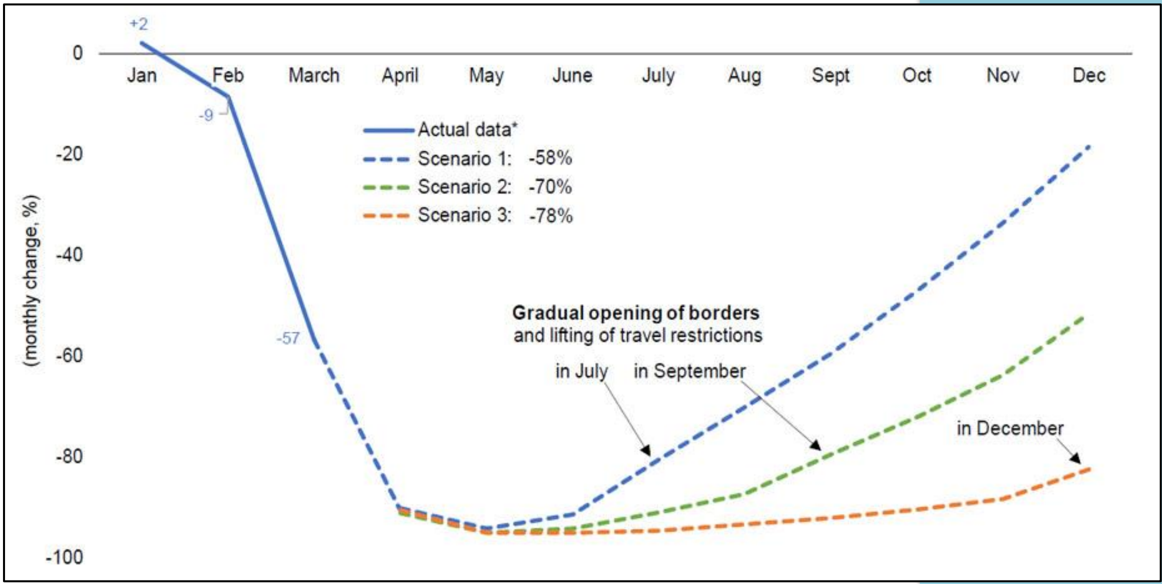


Figure 4.9: Regaining of travel and tourism in the world

Source: UNWTO

4.9 Government revenue collection

In contrast to the well-established neoliberal hegemony of minimum state involvement in the economy, the spread of the COVID-19 pandemic paved the way to intensify the role of government operations in an economy, especially at a time of unexpected shock.

In Sri Lanka, where the state footprint in the economy has become common practice, extensive action was taken by the government to prevent the community spread of the virus. On the other hand, considering the disruptions to livelihood of the general public, steps were taken to provide financial transfers as a supporting system for low-income earners. In addition, the public sector employments of around 1.4 million were also maintained without laying off and paying salaries even though most of the institutions were not full operation. All these facts were presented to infer that the government expenditure would have a considerable upsurge due to the COVID-19.

However, even before the pandemic affected the fiscal sentence of the country, Sri Lanka had been suffering from weaker fiscal conditions for years. The lower direct tax revenue combined with the mounting government expenditure the country has been suffering from a prolonged fiscal deficit which in turn transformed to a higher levels of indebtedness to both domestic and foreign sources.

On this backdrop we investigated on how this already apprehensive condition would be affected through the pandemic and the economic disruptions that followed in the country.

> Even before the pandemic, Sri Lanka has been suffering from weaker fiscal conditions for years. The lower direct tax revenue coupled with the mounting government expenditure the country has been suffering from a prolonged fiscal deficit which in turn transformed to a higher levels of indebtedness.

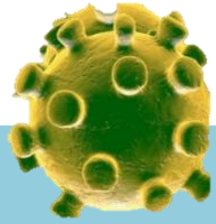
The impact of direct tax collection

Before moving on to discuss the findings of the interview, it should be noted that the trends and patterns of government revenue in 2020 is not only affected by the COVID-19 pandemic. Following the 8th presidential election of the country, some key reforms were introduced to the Inland Revenue Act, 2017. Deviating from the initial motive of the act - the revenue- based fiscal consolidation, the new amendments were put in place with the aim of stimulating the demand-side factors to improve the sub-par economic growth in the country during the recent past.

These policy measures included policy options such as reduction of value-added tax (VAT) to 8%, and the abolition of the Nation Building Tax (NBT) and Withholding Tax (WHT), as well. In addition, the income tax threshold level was also adjusted upward to LKR 250,000 per month and the Pay as You Earn (PAYE) tax was removed. While these measures would help to stimulate the demand in the short run, these expansionary fiscal policy measures have negative implications on the entire government revenue collection process.

Thus, when the COVID-19 impact on government revenue is considered, these policy changes and their impact should also be adhered to, to derive a clear picture.

According to the findings of the interview, data for the first quarter of 2020 may actually indicate the substantial effects of the above policy changes whereas the real impact of the economic disruption due to the COVID-19 would be felt within the next quarter. Therefore, the comparison of the revenue figures of the 1st quarter of 2019 and the 1st quarter of 2020 without accounting for the expansionary fiscal policy measures mentioned above would



generate misleading inferences. However, to get an overall idea about the possible implications, we will consider the latest available data, as well.

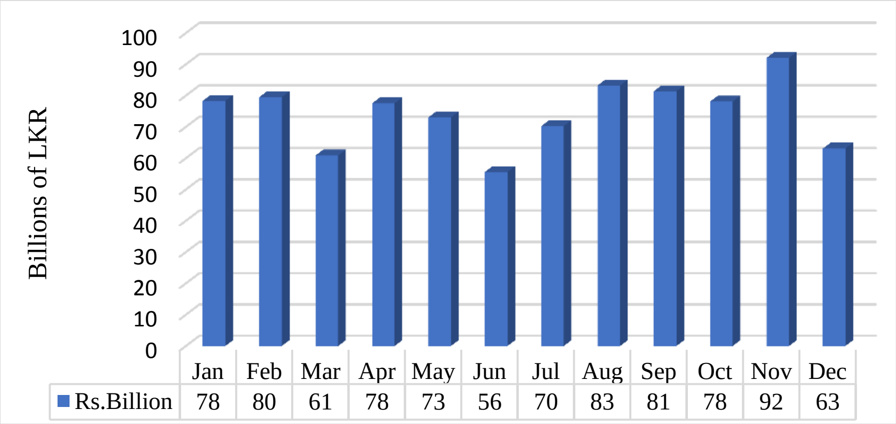


Figure 4.10: Distribution of monthly revenue collection in 2018

First, we will examine the monthly revenue collection data to get a basic idea of the distribution of tax collection during a period of 12 months. As the data indicates, the revenue collection is not equally distributed throughout the year (see Figure 4.10). Our attention is mainly on the second and third quarters of the year, as we expect the COVID-19 impact to be felt immediately during this time. The two months, April and May, when the COVID-19 was prominent in the country, were months that the revenue generation is usually high. Then in August and, September the revenue collection goes up again. The reasons for this behaviour lie on the tax calendar of the country, as pointed out during the interview. According to the tax calendar, in April, the quarterly VAT for the first three months of the year is paid. In the following month, one instalment of income tax payment is made. (This is with respect to the 1st quarter of the year).

The two months, April and May, when the COVID-19 was prominent in the country, are months collecting a high level of tax revenue for a normal year in Sri Lanka's tax calendar.

However, as we argued above, the real impact of the COVID-19 disruptions will be shown in the next quarter of the year as emphasized in the interview as well. The 15th of August marks another important day in the tax calendar where the second instalment of the income tax needs to be paid, and in September, where any amount left in the income tax is settled. Therefore, these two months also record a higher level of revenue, compared to other months. It would be impossible to provide a complete picture at the time of writing this report and we will have wait for a few more months.

As a result, all three contributors to VAT namely, manufacturing sector, the Non-manufacturing sector and imports, will be adversely affected due to the COVID-19 pandemic.

The cumulative tax revenue of the government during 2018 was LKR 893 billion, whereas it went down to LKR 785 billion in 2019. As per the targets given for 2020, further reduction is expected with the given tax concessions. Therefore, the declared revenue target for 2020 is LKR 613 billion, and it is more likely that the IRD may not be able to reach the aforementioned target with all the complications during the first few months of the year.

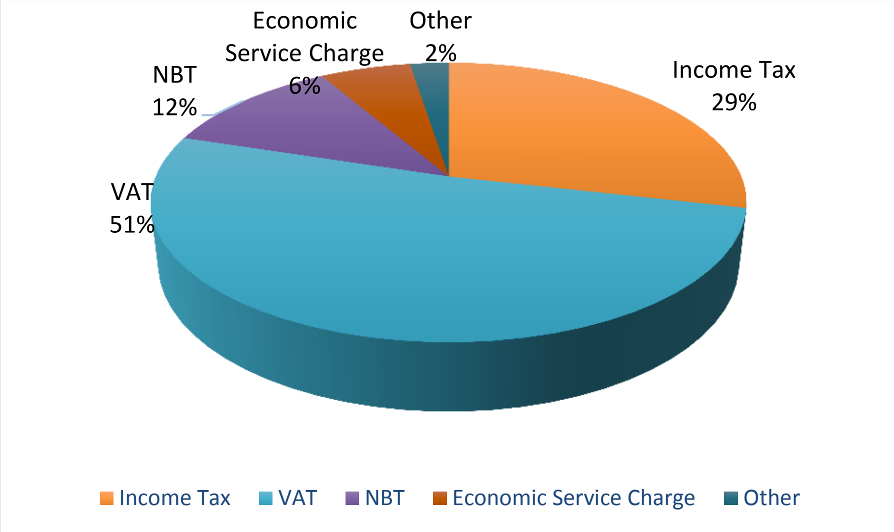


Figure 4.11: Percentage distribution of tax revenue of Sri Lanka-2019

Next, we will investigate the tax structure in order to understand how it will be felt on the direct tax and indirect tax collection. The data illustrates the prolonged structural issue in the fiscal policy. For instance, during 2018, more than 50% of the revenue has been collected through VAT, whereas the income tax revenue was only 29%. The 12% contribution to the total revenue that came from the NBT will not be there any more, as it has been abolished as noted above (see Figure 4.11).

Even within the VAT, the three main contributors are the manufacturing sector, the Non-manufacturing sector and imports. While the COVID-19 adversely affected the first two sectors, macroeconomic complications generated through the pandemic directed the government to impose restrictions on imports. As a result, all three contributors to VAT will be adversely affected due to the COVID-19 pandemic.

In terms of direct tax collection, the abolition of PAYE tax and upward adjustment of the threshold levels following the presidential election in last year combine with the economic shock of the COVID-19 are likely to have a sizable impact on the overall revenue of the government. According to 2018 data, there were around 0.7 million individuals who were registered for the PAYE tax in the country. However, with the new tax amendments mentioned above considerable portion of the above taxpayers will not be eligible pay income tax under new income tax threshold level. While the number of income tax payers would decline, the contribution coming from the cooperate taxes would also see a decline as a result of the reduction of cooperate tax rate to 24% from previous 28%. This reduction in the cooperate tax rate would not bring down the total amount of cooperate taxpayers, nevertheless the absolute amount of the revenue generated through the cooperate tax would go down. As the cooperate performance are adversely affected by the COVID-19 pandemic lower cooperate profits would further reduce the revenue generated from the cooperate tax.

However, showing a silver line in the dark clouds: The importance of adopting technology into the revenue collection process is proven very important during this period. As findings of the interview suggest, even though some services such as registration for tax, was facilitated on the digital platform even prior to the pandemic, the Inland Revenue Department took immediate action to establish an online platform to facilitate the tax collection and administrative services as well. This platform became very useful during this period.

Many new tax files were opened using the platform during the curfew period when people were unable to reach the Inland Revenue Department physically. Furthermore, almost one third of all previous operations are now taking place through this Alternative Tax Payment System (ATPS). Given the flexibility of operations and all other advantages of the online service, the online platform is expected to expand in years to come.

Overall, with the existing data, providing a clear picture on the COVID-19 impact on the government revenue generation is impossible. However, given that the government has been suffering from fiscal deficit for so long, planning should be made for expenditure rationalization and prioritization of the expenditure. On the other hand, the government should look for alternative ways to curb the negative impact of lower revenue by managing state-owned enterprises such as the Ceylon Petroleum Cooperation (CPC)

Many new tax files were opened using the platform during the curfew period when people were unable to reach the Inland Revenue Department physically. Furthermore, almost one third of all previous operations are now taking place through this Alternative Tax Payment System (ATPS).

and the Electricity Board to make profits and to minimize the negative impact of the revenue loss.

4.10 Banking and finance sector

The policies to re-energize the Sri Lankan economy in the post-COVID-19 period have recognized the banking and finance sectors to be a vanguard force in reshaping the Sri Lankan economy in the post-COVID-19 period. As a result, policy directions have been issued to financial institutions to impose numerous financial stimulus packages to facilitate the smooth functioning of the economy. On the contrary, the scope of this chapter is not to investigate such policy stimulus but to identify the impacts of the ongoing pandemic on the banking and financial sectors of the country.

The relative importance of the financial sector in the Sri Lankan economy

Even before the pandemic started in the country, the banking and financial sector was performing below its potential.

Financial, insurance, and real estate activities including ownership of dwellings together contributed 14.2% to the overall GDP of the country during 2019, which was the second-largest contributor to the GDP in the services sector after wholesale and retail trade.

According to the latest available annual data, the total assets holdings of the financial sector of the country was dominated by the banking sector with 71% of total assets while other deposits taking financial institutions and specialized financial institutions were holding 8.2% and 1.4 % of total assets of the financial system, respectively. As the latest annual report of the Central Bank highlights, in line with the subdued economic activities of the country in last year, the financial sector performance was also affected during 2019 which factor emphasizes the point that even before the COVID-19 pandemic, the subdued economic activities of the country was affecting the financial sector as well. Thus, a key point that needs to be kept in mind before going to any further discussion is that even before the pandemic started in the country, the financial system was performing below its potential.

It should be noted here that considering this relative importance of the banking sector within the financial sector, the pandemic impact analysis pays attention to the banking sector.

The COVID-19 impact

As a result of the subdued performance of the economy during the previous year, the quality of the assets of the banking sector was adversely affected by lower demand for loans and increasing Non-Performing Loans (NPL). This led to the deterioration of the quality of the assets of the banking sector that year. As the economic shock of the pandemic unfolded on the Sri Lankan economy, this would further escalate as major sectors of the economy such as construction and tourism are expected to show underperformance in the post-COVID-19 period.

Accordingly, the profitability of the banking sector was also deteriorating during last year, as reflected through the decline of the Return on Assets (ROA) and Return on Equity (ROE) ratios. Apart from the quality of the declining assets, the rise in operating cost and increase in taxes also fuelled this change.

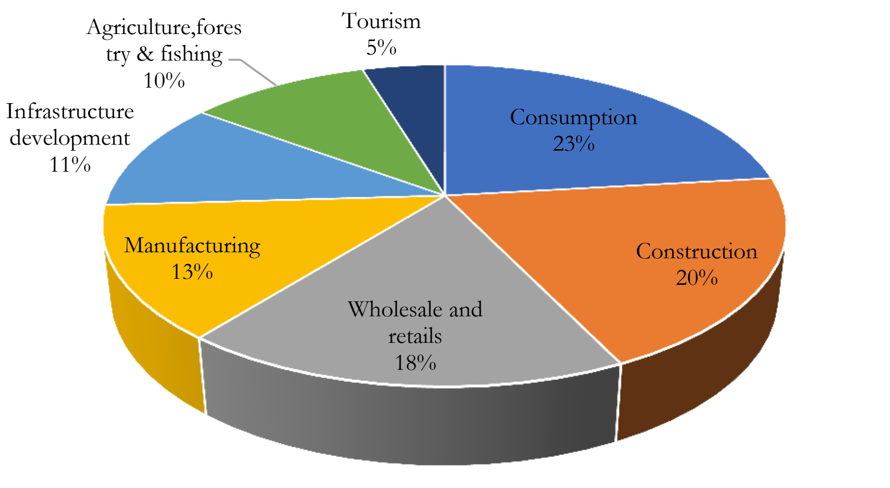
The assets composition of the banking sector is dominated by loans and advances, followed by investments. On the other hand, the liability structure is dominated by deposits from customers, followed by bank borrowings. Even though we could not come to a decision on the COVID-19 pandemic impact on the financial sector by looking at these numbers, it is possible to understand the likely impacts by looking at these key assets and liability components.

Table 4.4: The percentage composition of assets and liabilities in the banking sector

Assets	2018	2019
Loans and Advances	65.2	64.9
Investments	22.7	23.9
Other	12.1	11.2
Liabilities		
Deposits	72	73.2
Borrowings	15	13.4
Capital Funds	8.7	9
Other	4.3	4.4

Source: CBSL annual report (2019)

The profitability of the banking sector was also deteriorating during last year, as reflected through the decline of the Return on Assets (ROA) and Return on Equity (ROE) ratios.



Source : CBSL annual report (2019)

Figure 4.12: Composition of loans and advances of the banking industry (2019)

On one hand, new investments will be affected, limiting the demand for credit in the future, on the other hand, the ability to repay the already obtained loans also has negative prospects. These likely implications would have duel impacts on the banking sector NPLs.

The sector-wise composition of the loans and advances of the banking sector provides a clear view that there will be a significant impact on the quality of the assets of the banking sector, as many of the borrowing sectors such as consumption, construction, manufacturing, and tourism sectors, are likely to experience the adverse economic implications of the pandemic in the short and medium terms.

As such, sector performances are likely to stagnate. On one hand, new investments in these sectors will be affected, limiting the demand for credit in the future, on the other hand, the ability to repay the already obtained loans also has negative prospects. These likely implications would have duel impacts on the banking sector and the financial sector at large, which is the increase in the NPLs of the bank's balance sheets, and which would be affecting the quality of the assets of the banking sector, while lower investments in the sectors mentioned above would limit the growth credit in the country, limiting future growth prospects as well.

However, what is more worrying is that even before the pandemic began, the banking sector was experiencing increasing NPLs in their balance sheets due to the economic disruptions that took place during the previous year. These rising NPLs would affect the soundness of the financial system. Further, the credit ratings of the banking sector were downgraded by the rating agencies in the recent past.

For example, in March 2020, the Fitch ratings revised the outlook of Sri Lanka's banking sector to negative, based on the reasons outlined above, and in line with the sovereign ratings of the country to 'B-'/Negative from 'B'/Negative on 24th April 2020. However, this step was condemned by the Central Bank, reemphasizing Sri Lanka's ability to maintain the credibility of repaying its debt. Thus, on 10th June, the Fitch rating revised the National Long-Term Ratings of Sri Lankan financial institutions following the recalibration of the agency's Sri Lankan national rating scale. Thus, credit ratings of eleven financial institutions in the country saw an upward adjustment in their ratings. Fitch also highlighted that revision of ratings are used to modify ratings for reasons that are not related to credit quality in order to reflect changes in the national rating scale.

Thus, the risk of rise in NPLs by the end of the year is expected to have a larger impact on banks and financial institutions with smaller portfolios and with greater exposure to retail and SME accounts.

With all these negative prospects the digital banking segment was proved to be important, especially during the time of the lockdown. The cashless mode of payment and online banking became prominent and even the technology-driven alternative self-banking practices instead of the traditional practice of over the-counter banking became significantly important during this period. This adjustment of customer behaviour to more technology-driven banking practices signals the future of banking in the country and possibly shows the need for investing in this segment for the rest of the players in the financial sector, as well.

Regulatory measures

The Central Bank being the main regulatory authority of the financial sector took action to ensure the soundness of the financial system as well as to ensure the availability of funds for the private sector, at the same time.

The conduct of the monetary policy was towards the market-friendly monetary policy sentence in the recent past, admitting the slower growth of credit demand. As a result, the policy rates were adjusted downwards expecting the banks to follow suite. However, lending rates of the banks were not brought down by the banks, which led to no significant change in credit to the private sector. In fact, as market analysts indicate, these excess funds were used by the banks to invest in government securities to improve their assets quality.

Despite all these negative prospects the digital banking segment was proved to be important, especially during the time of the lockdown. The cashless mode of payment and online banking became prominent and even the technology-driven alternative self-banking practices instead of the traditional practice of over the-counter banking became significantly important.

As an initial remedial measure the Central Bank introduced a LKR 50 billion refinancing facility to help affected sectors of the economy. The eligible sectors were identified as Small and Medium-term Enterprises (SMEs), tourism, exports, imports-related business and self-employments. This facility includes debt moratorium for up to 6 months for both individual and business loans. Also it includes new provisions for NPLs as well. While some of the benefits of the packages were not achieved, some measures were used by fixed income earners who had no disruptions to their income source, and also enjoyed the benefits.

As the result of the discussion had with the president, the Central Bank again took action to further reduce the policy rates, allowing excess cash into the system. Consequently, the Statutory Reserve Ratio (SRR) was adjusted downward to by 200 basis points to 2%, with effect from the reserve maintenance period that commenced on 16th June 2020. This reduction is expected to inject approximately LKR 115 billion of additional liquidity to the domestic money market, enabling the financial system to expedite credit flows to the economy.

Central Bank will provide funding to Licensed Commercial Banks (LCBs) at the concessionary rate of 1.0% against the pledge of a broad spectrum of collateral, on condition that LCBs in turn will on-lend to domestic businesses at 4.0%

Furthermore, according to the provisions in Section 83 of the Monetary Law Act No. 58 of 1949, a new credit scheme was also introduced on 16th June 2020 Accordingly, in addition to the already disbursed LKR 27.5 billion under the refinance scheme introduced on 27th March 2020, the Central Bank will provide funding to Licensed Commercial Banks (LCBs) at the concessionary rate of 1.0% against the pledge of a broad spectrum of collateral, on condition that LCBs in turn will on-lend to domestic businesses at 4.0%, while ensuring the greatest possible distribution of this facility.

In addition, addressing the delayed payments for the construction sector by the government: Construction sector enterprises will be provided with a facility to borrow from LCBs, using guarantees issued by the government equivalent to the amount due on account of contracts carried out in the past.

However, this move alone will not ensure economic benefits of the availability of the excess cash in the system unless steps are taken to ensure the benefits of these policies spill over to the public. If not, like in all the other cases, the banks will play out with the concessions for their own benefit at the cost of national economy. On the other hand, with the reduction of interest rates it will be difficult to attract foreign investors to the bond market, which will generated unnecessary complications, as well.

Also banks were given the chance to draw down the capital buffers to ensure the credit flow of the financial system while the relaxation of NPL clarifications was expected to bring flexibility into bank balance sheets. However, with the loan moratorium measures and other measures imposed on the banking sector, a further decline the profitability of the banking sector is expected.

In conclusion, the banking sector is absorbing adverse effects from not only the ongoing pandemic but also the negative impacts of subdued economic activities during the previous year. On this backdrop, the sector is expected to experience a worsening balance of payment conditions. The lower credit growth and the possibility of rising NPLs would affect the quality of the assets and the liability structure of the banking system. However, the investments in technology-driven banking practices would benefit financial institutions in the post-COVID-19 period as people get used to the new normal situation.

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4.11 Government relief package and its implications

On March 23rd, the government issued directives to the Central Bank Governor, all ministry secretaries, chief secretaries of Provincial Councils, heads of all banks and leasing companies to grant these relief measures to the people.

The following list includes salient relief measures rearranged to reflect the responsible parties

Treasury/Government/Inland Revenue

- A grace period for the payment of income tax and VAT, driving license renewal fee, water bills and assessment tax less than LKR 15,000, be extended until 30th April 2020.
- The LKR 20,000 allowance for the graduates chosen to follow the training at divisional secretariats will be credited to their bank accounts.
- The *Agrahara* insurance benefits for health workers engaged in Coronavirus prevention activities, (the Police, Civil Security personnel and other government employees) to be doubled.

- VAT exemptions were granted to Lanka *Sathosa* and cooperative stores.
- In the face of the current COVID-19 threat, the Bank of Ceylon has opened a special account at the Presidential Fund to provide relief for health and social care. LKR 100 million has been allocated from the Presidential Fund for this purpose. Tax and foreign exchange control restrictions have been lifted for all local and foreign donors who contribute.
- The Government of Sri Lanka donated USD 05 million to the SAARC COVID-19 Emergency Fund.
- A household transfer payment of LKR 5000x2 was made to economically deprived families.

Samurdhi Authority

- The *Samurdhi* Authority should issue title certificates to *Samurdhi* and low-income families immediately for issuing nutritious food items to persons of low income. They should be provided with rice, dhal and salt on a weekly basis with their food cards.
- *Samurdhi* beneficiaries and *Samurdhi* card holders to be offered an interest free advance of LKR 10,000 through all *Samurdhi* Banks.

Central Bank and other banks

- Monthly credit card bills less than LKR 50,000, to be extended until 30th April 2020.
- Suspend the leasing loan repayment of three-wheeler owners for a period of six months.
- Suspend the recovery of loans from the salaries of government employees and private sector employees until 30th May 2020.
- Suspension of loan repayments for personal loans less than one million borrowed from banks and finance companies for three months.
- A six-month debt moratorium will be granted to the tourism, apparel and SME for which the Central Bank will bear the cost of the moratorium.
- The Bank of Ceylon, People’s Bank, National Savings Bank, Sri Lanka Insurance Corporation, Employees Provident Fund and Employees Trust Fund to jointly invest in Treasury Bonds and

The Government of Sri Lanka donated USD 05 million to the SAARC COVID-19 Emergency Fund.

Bills, thereby stabilizing the money market at a 7% interest rate.

- A maximum of 15% interest rate has been stipulated for credit card domestic transactions up to LKR 50,000 and a 50% reduction in minimum monthly charges.
- All bank branches to remain open during non-curfew hours providing maximum service to customers.

Impact on government budget

In 1999 the government introduced two rounds of fiscal stimulus. The first is to stimulate the economy slowed down by the Easter Sunday attacks. The second is to ease measures promised at the Presidential Election 2019. The most significant proposals among the first round included the reduction of the VAT rate from 15% to 7% on hotels and tour operators, to support the restoration of the tourism industry and tax exemptions on imported security equipment subsequent to the Easter Sunday attacks. The second round of fiscal easing included amendments to the Inland Revenue Act, No. 24 of 2017, introducing a broad-based reduction of the VAT rate to 8%, except for financial services; and removal of the Nation Building Tax (NBT) and Withholding Tax (WHT). Furthermore, revisions were introduced to personal income tax rates, tax-free threshold and tax slabs with effect from 1st of January 2020.

Following the tax reforms, tax revenue declined to 11.6% of the GDP in 2019 from 11.9% of the GDP in 2018 as a result of the lower revenue collection from excise duties, VAT, SCL, Cess, and PAL despite a significant increase in revenue collection from income taxes. (Central Bank Annual Report 2019, 118)

As a result of the several health policy and fiscal measures introduced by the government in response to the spread of the COVID-19 pandemic, including the unexpected allocations for health facilities, imposing price ceilings for essential food items and facilitating the distribution of food items, relief funds, strengthening social nets, doubling household transfer payments during periods of lockdown, the fiscal position of the government weakened further. The transfers to households, which accounts for 18% of recurrent expenditure for a normal fiscal year (see Figure 4.13), would have increased by nearly 2% this year.

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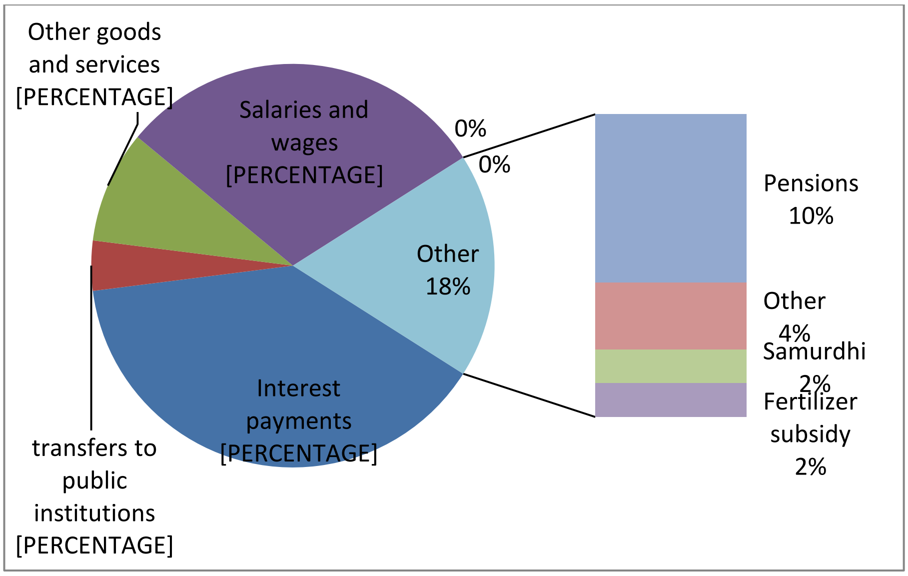
The government continued to print money in substantial amounts. For the two months' period from 1st March to 30th April 2020, Treasury Bill holdings of the Central Bank has risen from LKR 78 billion to LKR 291 billion, which means that the government has printed money more than LKR 200 billion.



Source CBSL; Annual report 2019

Figure 4.13: Composition of government recurrent expenditure - 2019

During the COVID-19 pandemic, tax collection delayed. As a solution to the government liquidity problem, the government continued to print money in substantial amounts. For the two months' period from 1st March to 30th April 2020, Treasury Bill holdings of the Central Bank has risen from LKR 78 billion to LKR 291 billion, which means that the government has printed money more than LKR 200 billion within two months, threatening the price stability of the country for the 2nd quarter of 2020. However, this helped to sustain the aggregate demand at the required level to keep the economy on the move in a distress situation where the vast majority has lost their income sources.

Impact on Sri Lanka Severing Credit Ratings

Standard and Poor's and Fitch ratings, the international rating agencies, downgraded Sri Lanka sovereign credit ratings to B-.

On 24th April 2020, in the downgrading statement, the Fitch Ratings reports that they expect the COVID-19 outbreak to push Sri Lanka's economy into a recession in 2020, against earlier expectations of a rebound. This would weaken Sri Lanka's already-fragile fiscal position. Some progress in the government budget had been made under an International Monetary Fund programme but the process had been hampered recently. Instead of waiting for a cyclical recovery to take place after a currency collapse in 2018, Sri Lanka slashed taxes from January in fiscal stimuli. Rate cuts were also made in January despite a widening fiscal deficit. Large volumes of money were ”helicopter-dropped” in the banking system to enforce the lower rates in a monetary stimulus despite the country having a pegged monetary regime with low credibility. Fitch Ratings lowered credit ratings of Sri Lanka based on the assessment that the country’s fiscal position has weakened substantially amid a COVID-19-induced recession (EconomyNext, May 20, 2020).

Table 4.5: Sovereign Credit Ratings of Sri Lanka as at 20 May 2020

Agency	Rating	Outlook	Date
Fitch	B-	Negative	24-Apr-20
S&P	B-	Stable	20-May-20

Government household relief programs

Under the Government Relief Fund (cash) transfer programs of LKR 5,000 per head, eight differently affected categories namely (1) elderly (2) disabled (3) kidney patients (4) sick (5) senior citizens (6) direct and indirect livelihood affected (7) public transfers (8) *Samurdhi* recipients were benefitted. Although the official statistics are still not available, a huge amount of money was added to circulation through these programs. For example, the community residing Beruwala Divisional Secretariat (DS) division alone received LKR 243 million approximately. There are 256 DS divisions in the country, not equal in geographical size and population. In most of the DS divisions, all except government employees and pension holders received these cash benefits. Some families collected more than LKR 20,000 as a combination of a few categories. Therefore, the money spent on household transfers by the government is substantial.

Nevertheless, the government relief programme was substantially supported by the local and international donors. For example, the Government of Canada has provided more than CAD 56,000 (approximately LKR 7.5 million) to support Sri Lanka’s response to the COVID-19 pandemic through targeted relief to some of those most affected in vulnerable communities. The funds were granted to the National Peace Council of Sri Lanka which is part of the Civil Society Committee of the Presidential COVID-19 Task Force.

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4.12 Chapter summary

Though almost all the sectors of the economy hit by the COVID-19 this chapter investigated the impact on selected sectors of the economy and following are the highlights:

The production and employment base of most MSMEs were significantly hit by the COVID-19 pandemic. Approximately 80% of enterprises was exposed to suffer production and employment drops. More than 80% of the MSMEs are facing falling sales due to delayed or cancelled orders by the domestic and foreign buyers. The most severely affected enterprises were the "Accommodation and food Service" sector, which is the major part of the tourism industry. Nearly 10% of MSMEs in the apparel and textile industry in Sri Lanka have shifted their production towards protective clothing such as face masks under the pandemic environment. Approximately 15% of MSMEs have benefited under the current crisis. Retail and wholesale trade, Ayurveda medicine activities, and computer sales have been continuing their business without a drop in sales.

The COVID-19 pandemic has kept investors in suspense since February, putting markets in into high levels of volatility, divestments, and flight into "safer haven assets". The stock price, in absence of speculation, is a reflection of the company's business performance. The COVID-19 badly hit or devastated industry sectors such as tourism, aviation, automotive, constructions, manufacturing including textiles & garments, whereas marginally boosted some sectors such as agriculture, e-commerce, telecommunications, pharmaceuticals, and medical service. The impact on tourism, automotive, constructions, manufacturing including textiles & garments will be lasting over one year or so, whereas education, aviation, banking & commercial services and transport will be recovered in a short period of time, hopefully within three months.

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The textiles and garment industry recorded USD 5.6 billion of export earnings in 2019. The estimated losses for the 3 months' period 15th March to 15th May round up to USD 1,400 million. The most alarming signal is that 45% of the Sri Lankan export market depends on the USA which is the most COVID-19 affected country in the world, followed by the UK (14%), Italy (8%) and Germany (6%), the second most severely COVID-19 hit country. Demand contractions could result in a reduction of apparel exports by an additional 30 -

40% after June, due to mass cancellations of orders by buyers and problems in the purchasing of necessary raw materials. These circumstances, coupled with delayed shipments, forced discounts and currency depreciation, have led to working capital problems across the industry.

The construction sector was already suffering from delayed payments for government-financed projects and lower demand for high-end condominium developments. On this backdrop the construction sector would face constraints in meeting contractual agreements on completion dates and costs. While labour and related issues would also affect the performance of the construction sector in the short run due to health standards, the raw material-related issues are also expected with the imposition of import controls.

Consumer goods sales volume of large-scale institutions crashed while the medium and small-scale businesses were willing to normalize within several weeks after lifting the curfew. The production capacity dropped by 50% as a result of the working from home concept. The supply chain and the reinvestments of the industry are at risk because of the profit loss and shrinking cash flows. The changing lifestyles and income levels sharply affected the consumer goods industry. The industry has to find new ways to reach the customer in a more efficient manner.

Travel bans, mobility restrictions, lockdowns and border closures disrupted global travel with the pandemic outbreak. Sri Lanka's tourism was significantly affected. Tourist arrivals reached the bottom line. The expected loss of revenue is more than USD 300 billion. Zero income resulted in the layoff of temporary and casual employees, while permanent employees are also at high risk in job security with the current salary freeze. Around 20% of indirect employees lost their income. Zero income created a financial distress on investors who were trapped by indebtedness despite the loan moratorium granted for a few months. Investors are likely to leave the industry though there are no threats on mortgaged property to foreclose.

With recent amendments in the tax laws the exact impacts of the COVID-19 economic shock on revenue collection must be studied carefully. The real impact of the pandemic will be seen towards the end of the fiscal year as indicated in distribution of tax collection in a

Tourist arrivals reached the bottom line. The expected loss of revenue is more than USD 300 billion. Zero income resulted in the layoff of temporary and casual employees, while permanent employees are also at high risk in job security.

year. All in all, as far as the fiscal policy is concerned, prolonged fiscal deficit is highly likely to further escalate during the year. Thus, the greatest challenge in financing this deficit is not to crowd out the private investment, which, on one hand, will cost the future economic growth of the country, and on the other hand, not to expand external financing to an unmanageable level which will risk both future growth and sovereignty of the country. S&P and Fitch Ratings downgraded Sri Lanka sovereign credit ratings to B-. This would weaken Sri Lanka's already-fragile fiscal position as the credit facilities will be tightened by international sources.

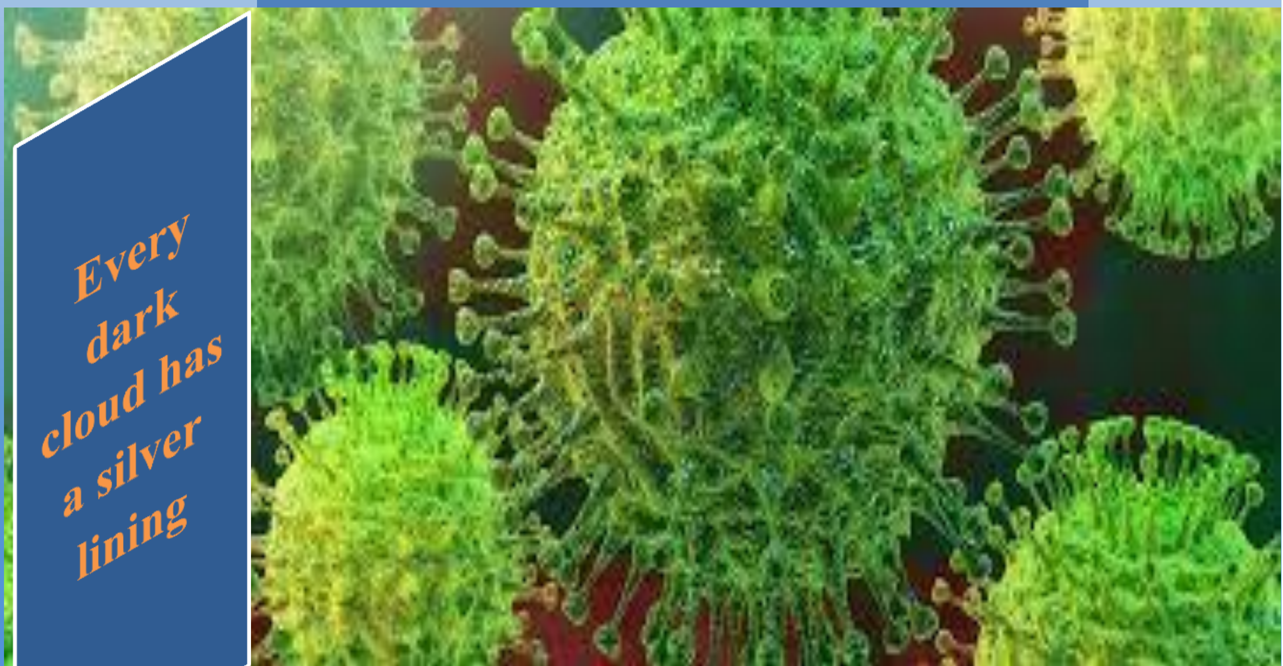
The fiscal position of the government has weakened following the unexpected allocations for health facilities, imposing price ceilings for essential food items, relief funds, strengthening social nets and doubling household transfer payments, during the lockdown. The household transfers which accounts for 18% of recurrent expenditure for a normal fiscal year, would have increased by nearly 2% this year. During the COVID-19 pandemic, tax collection was delayed. As a solution to the liquidity problem, the government continued printing money in substantial amounts. For the two months ending 30th April 2020, the government has printed money more than LKR 200 billion, threatening the price stability of the country. However, this helped a lot in sustaining the aggregate demand at the required level to keep the economy on the move in a distress situation where the vast majority has lost their income sources.

Non-Performing Loans (NPLs) are expected to go up in the short and medium-term, which can be a risky.

On the one hand, while the assets quality of the Banking Sector is expected to go down, the demand for credit will also go down, as almost all leading sectors are confronted by the pandemic. On the other hand, Non-Performing Loans (NPLs) are expected to go up in the short and medium-term, which can be a risky. Even though various regulatory measures have already been taken by the Central Bank to give a positive shock to economic activities, the effectiveness of such policies in reaching the expected outcomes is questionable. Moreover, the most recent policy directions issued by the Central Bank show that they are yet to address the real issue in the system. Therefore, to reach the benefits of the revival policies while ensuring the soundness of the financial system, it is inevitable to face the trade-off between economic growth and price stability.

CHAPTER V

POLICY IMPLICATIONS FOR POTENTIAL RECOVERY ON POST COVID-19



Every dark cloud has a silver lining

Policy Implications for Potential Recovery on Post COVID-19

5.1 Introduction

Although the COVID-19 hit hard on Sri Lankan households, the majority of its impacts is temporary, and is being recovered in the post-COVID-19 period. The most vulnerable group in society is the day payment workers and thus, government intervention is required to protect their livelihood. During the COVID-19 pandemic, the government implemented a relief package for such groups and need good management in the process of distribution and its continuation for months to come, while establishing necessary regulatory measures to regain the whole economy.

Our prospect for the Sri Lankan economy in the second and third quarters of 2020 is a negative growth. Sri Lanka has little hope about the remedial measures about the sectors mostly dependent on the global economy such as tourism receipts, foreign remittance and earnings from garment and textiles. However, there are many sectors in the economy that can be boosted by stimulating the domestic aggregate demand. Aggregate demand expansion policies can be prescribed in a crisis situation. We recommend using both expansionary fiscal and expansionary monetary policy to increase the aggregate demand.

5.2 Monitory policy

The Central Bank being the main regulatory authority of the financial sector took action to ensure the soundness of the financial system as well as the availability of the funds for the private sector at the same time. Accordingly, the policy rates were adjusted downwards expecting that banks would follow suite. The lending rates of the banks were brought down but even the approved loans have not been released fully until the Central Bank committed for refinance. In fact, these excess funds were used by the banks to invest in government securities to improve their assets quality.

The lending rates of the banks were brought down but even the approved loans have not been released fully until the Central Bank committed for refinance.

As an initial remedial measure, the Central Bank introduced a LKR 50 billion refinancing facility to help affected sectors of the economy. Eligible sectors were identified as Small and Medium-term Enterprises (SMEs), tourism, exports-imports-related business and self-employment. This facility includes debt moratorium for up to 6 months for both individual and business loans. It also included new provisions for NPLs. While some of the benefits of the packages were not achieved, some measures were used by fixed income earners who had no disruptions to their income source and they were also enjoyed the benefits.

Paying attention to this issue and the failure of the Central Bank to address the issue, the president was also critical about the issue. As a result, the Central Bank took action again, to further reduce the policy rates allowing excess cash into the system. As a result, the Statutory Reserve Ratio (SRR) was adjusted downward by 200 basis points to 2.0%; the lowest ever rate, with effect from the reserve maintenance period that commenced on 16th June 2020. This reduction is expected to inject approximately LKR 115 billion of additional liquidity to the domestic money market, enabling the financial system to expedite credit flows to the economy.

Further, according to the provisions in Section 83 of the Monetary Law Act No. 58 of 1949, a new credit scheme was also introduced on 16th June 2020. Accordingly, in addition to the already disbursed LKR 27.5 billion under the refinance scheme introduced on 27th March 2020, the Central Bank will provide funding to Licensed Commercial Banks (LCBs) at the concessionary rate of 1.0% against the pledge of a broad spectrum of collateral, on condition that LCBs in turn will on-lend to domestic businesses at 4.0%, while ensuring the greatest possible distribution of this facility.

In addition, addressing the delayed payments for the construction sector by the government, construction sector enterprises will be provided with a facility to borrow from LCBs, using guarantees issued by the government equivalent to the amount due on account of contracts carried out in the past.

However, this move alone will not ensure economic benefits of the availability of the excess cash in the system, which would re-energize the economy unless steps are taken to ensure that the benefits of these policies are levered into the general public. If it is not like in all the other cases, the banks will play out with the

The Central Bank introduced a LKR 50 billion refinancing facility to help Small and Medium-term Enterprises (SMEs).

The Central Bank needs to monitor low interest refinance loans (at 4%) going to finance genuine working capital requirements of SMEs and affected industries.

Close monitoring requires as Non-affected industries also might apply for low cost bank funds and might redeposit in banks at a higher fixed deposit rate, resulting in a negative interest margin to the banking sector.

Refinance needs to be granted to commercial banks on a reimbursement basis. Otherwise, additional liquidity could be used by the commercial banks to increase their Treasury bill holdings.

concessions for their own benefits at the cost of national economy. On the other hand, with the reduction of interest rates it will be difficult to attract foreign investors to the bond market, which will generate unnecessary complications as well.

Also, banks were given the chance to draw down the capital buffers to ensure the credit flow of the financial system while the relaxation of NPL clarifications expected to bring flexibility into bank balance sheets. However, with the loan moratorium measures and other measures imposed on the banking sector, it is expected that the profitability of the banking sector will further decline.

All in all, the banking sector was absorbing adverse effects from not only the ongoing pandemic but also the negative impacts of subdued economic activities during the previous year. On this backdrop, the sector is expected to experience a worsening balance of payment conditions. The lower credit growth and the possibility of rising NPLs would affect the quality of the assets and the liability structure of the banking system. However, the investments in technology-driven banking practices will benefit financial institutions in the post-COVID-19 period as people get used to the new normal situation.

However, we recommend the following supplementary measures in order to gain the maximum benefit of the expansionary monetary policy.

1. The Central Bank to monitor low interest refinance loans (at 4%) going to finance genuine working capital requirements of SMEs and affected industries. Otherwise, the purpose will be lost in the event these funds are utilized to purchase real assets or increase unproductive consumption.
2. Non-affected industries also might apply for those funds and might redeposit in the banking sector at a higher fixed deposit rate resulting in a negative interest margin to the banking sector.
3. Refinance needs to be granted to commercial banks on a reimbursement basis. Otherwise, additional liquidity could be used by the commercial banks to increase their Treasury Bill holdings. Also, this will compel the commercial banks to do better credit evaluation before granting loans and thorough follow-up after granting loans.

5.3 Fiscal policy

Overall, with the existing data, providing a clear picture on the COVID-19 impact on the government revenue generation is impossible. However, given that the government has been suffering from fiscal deficit for so long, planning should be made to expenditure rationalization and to prioritize the expenditure.

The government should not promise any further tax reliefs or spend for unnecessary household transfer schemes with the aim of winning the forthcoming General Election. On the other hand, the government should look for alternative ways to curb the negative impact of lower revenue by managing the state-owned enterprises such as the Ceylon Petroleum Cooperation (CPC) and the Electricity Board to make profits and to minimize the negative impact of the revenue loss. However, as a support to the affected industries to overcome their liquidity problems, the government can delay the collection of EPF/ETF from such industries for a certain number of months and delay the renewal of licence and other permits that tide up business funds.

SLTDA can propose UNWTO to introduce Destination Risk Assessment Index (DRAI) for the post-COVID-19 period enabling international tourist to understand country risk.

5.4 Supply side policies

However, it is a required industry-specific policy measure to regain industries such as travel and tourism, MSMSE's and the textiles and garment industry.

In the case of travel and tourism, it is the most affected industry in the world and thus Sri Lanka, by itself, is unable to regain fast in the industry soon. However, as a popular destination, Sri Lanka needs its own new travel and tourism strategies and policies and the SLTDA is responsible. The policies should provide protection for both stakeholders and visitors. Stakeholders need protection for their financial distress while visitors must be protected in terms of health conditions. It is requested that the areas of tourism most in demand, such as *Ayurvedic* tourism, be identified. Online market surveys are required for such activities. Government involvement (primarily SLTDA) is indispensable in promoting the safety brand of Sri Lanka as a safe destination in the post-COVID-19 period. More tourism promotion campaigns are required around the world while round-table discussions are needed with financial institutions and investors in travel and tourism and government agents to retain the current investors in the industry apart from attracting more new investments until it the industry is normalized. There is a substantial positive and negative effect of "word of mouth" in tourism. Therefore, the government of Sri Lanka must initiate suitable mechanisms to absorb the positive effect of word of mouth of the early post-COVID-19 visitors to Sri Lanka.

Many of the countries regulate the tourism industry introducing new policies and strategies for travel and tourism. Therefore, Sri Lanka cannot expect a maximum number of visitors from its source markets. The promotion of domestic tourism will be a valuable alternative for regaining the industry since domestic demand is expected to recover sooner than international demand according to the UNWTO Panel of Experts survey. Policy-makers are advised to follow the UNWTO recommendations since Sri Lanka as destination heavily depends on the European market, as well.

The government should take a policy decision to purchase all music instruments, sport items and classroom utilities required for schools from local manufacturers.

SLTDA can propose UNWTO to introduce Destination Risk Assessment Index (DRAI) for the post-COVID-19 period enabling international tourist to understand country risk.

Micro, Small and Medium-Scale Enterprises have shown a downturn growth during the pandemic. A government-led formal mechanism should be established for developing linkages between MSMEs and other complementary institutions which will direct to maintain the sustainability of enterprises against the impact of the COVID-19 pandemic.

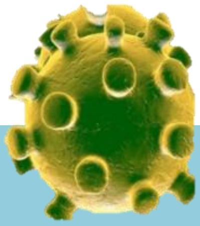
1. Promotion of the Public-Private Partnership Strategy (PPPS) for enterprises and the establishment of planned cluster-based enterprises may be the viable masterstroke for the future enterprise development scenario in Sri Lanka.
2. To address the financial issues of the enterprises, a SME-friendly banking system shall be established under the patronage of the Government and the Central Bank of Sri Lanka.
3. A National SME Portal shall be established to keep the important records of the enterprises in Sri Lanka. The portal may be operative 24 hours a day to receive problems and suggestions of MSMEs. The relevant institutions examine these issues and suggestions of enterprises to plan their timely support.

4. The government should take a policy decision to purchase all music instruments, sport items and classroom utilities required for schools from local manufacturers.
5. The government should take a policy decision that all government institutes, including schools, purchase domestically produced healthcare products that are needed in the post-COVID-19 period.
6. SMEs should shift a portion of their business online and the District Chamber of commerce should initiate a courier service, as another form of SME to home deliver SME products.
7. The government should limit import of certain products that can be successfully produced by SMEs in the required quality. These products should include items such as school bags, shoes and slippers, handmade paper, toys, wooden and plastic furniture and kitchen items.

The Colombo Stock Exchange (CSE) has entirely shut down due to the COVID-19 pandemic and was heavily affected by the closing down of all economic activities. The major loss is the massive outflow of foreign portfolio investments. The demand for the stocks of many domestic companies is hindered by their underperformance due to the pandemic. The debt moratorium for interest and capital payments and tax concession will ease financial pressures on those businesses. However, the government should not weaken the liquidity levels of banking institutions that are still performing well in the stock market, in its attempt to give concessions to other affected industries. Promotional campaigns will help raise international awareness and investor interest in Sri Lanka's Stock Market. The government has already started this not to promote the Stock Market but to sustain the sovereign credit rating without falling to CCC+. Encouraging firms to disclose their financial position and business performance to shareholders, and declaring dividends for the previous year will attract investors to the Share Market. However, it is advisable not to pay cash dividends until the liquidity positions of companies become normal.

The impact of the COVID-19 on the textiles and garment industry in Sri Lanka is unprecedented and second to none in both demand and supply sides. Recovery in the world market is beyond our control.

The government should limit import of certain products that can be successfully produced by SMEs in the required quality. These products should include items such as school bags, shoes and slippers, handmade paper, toys, wooden and plastic furniture and kitchen items.



The Government can suspend of EPF/ETF deduction from employers for 6 months as a temporary relief to maintain liquidity.

The following remedial measures are recommended to sustain the supply side until the international markets reinstate.

1. To reopen factories having pending orders in hand, subject to health directions, as early as possible, at their full capacity to avoid any further trade shifts that may take place in favour of competitors like Bangladesh, Cambodia, Vietnam and Indonesia, which are still fully operational despite the pandemic.
2. To explore new markets in play, including those related to new products currently in demand in Europe and North America.
3. Government approval to extend overtime (OT) hours from the legally permitted 60 hours to 90 hours for the 3 months beginning from June for the benefit of factories having overdue orders in hand.
4. To grant adequate loan facilities subject to the Credit Support Scheme referred to in the Central Bank Circular No.4 of 2020 dated 24th March 2020 to ensure the working capital finance of SMEs. According to the circular, SMEs are eligible to receive a six-month debt moratorium and working capital finance at 4% interest for at least 6 months, backed by refinance.
5. In the presence of an approximately LKR 650 billion revenue loss due to tax cuts introduced following the Presidential election last year, as well as delays in revenue collection during the pandemic, this will create a significant fiscal burden for the government to implement such stimulus packages by itself. Thus, it will be essential to issue directions to the commercial banks to grant loan facilities sufficient to pay a minimum of two months' basic salary for the SMEs without collateral but under the refinancing scheme of the government.
6. To suspend of EPF/ETF deduction from employers for 6 months as a temporary relief to maintain liquidity.

The engineering and construction sector is one of the core sectors that provide a substantial contribution to the GDP. Upon examining the challenges in the sector, the following possible policy directions can be drawn: Labour-related issues can adhere to the involvement of the government as a way of issuing a license or any other means for workers to reach their working sites. On the other hand, if a second wave does not happen in the country, restrictions on human mobility will be lifted as it is happening gradually at the moment. In the medium run, in-site health inspection facilities would be beneficial in large-scale construction projects to ensure a safe working environment. Also, the majority of small-scale operators should also be looked after with financial support. The cash flow - related issues should be handled as soon as possible to ensure smoothly-run operations, especially the delayed payments for government-funded projects which should also be looked after with a formal budget passed in Parliament for the better functioning of the sector.

It is a prudent decision by the government to facilitate construction firms to obtain low-cost funds from banks by surrendering their pending government receipts as collateral. This will help them to continue work and keep workers employed. The government should make this request not only from the domestic banks but also from the foreign banks like HSBC, Indian Overseas, Deutsche Bank AG operating in Sri Lanka.

The government should force the foreign contractors who have undertaken massive projects like highway construction to continue their work schedules uninterrupted. That will generate multiplier effects to increase national income.

Also, the skilled Sri Lankan workers who returned from the Middle East, South Korea, Italy and a few other countries are now unemployed. The government should look at the possibility of negotiating with large foreign construction firms operating in Sri Lanka to employ them as workers instead of getting down Indian and Chinese labour.

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Dropping of sales volume, loss of production capacity, decline of working capital, and change of consumption patterns were the main impacts of the COVID-19 on the retail and sales industry and the following policy recommendations can be made to regain the industry.

1. Introduce a mechanism for the supermarkets to buy agricultural products and green harvest directly from the farm gate without a middle man.
2. Promote advertising campaigns to change consumer taste towards domestically produced goods/food items.

The Government should limit import of luxury items including vehicles that cause huge outflows of foreign exchange until economy get back to normal.

3. Introduce an online ordering and home delivery system by supermarkets.
4. Include small-scale retailers and wholesalers too in the eligible category of low-interest working capital loans.
5. Reduce interest rates currently charged by the banks on Pledge Loans and Local Trust Receipt Loans (LTR) for wholesalers.
6. Encourage buyback agreements between farmers and wholesalers.
7. Open highways free of charge for the delivery of goods for 4 hours per day at midnight, after the lift of the curfew.

As overall policies it will be advisable for Sri Lanka:

1. to limit import of luxury items including vehicles that cause huge outflows of foreign exchange.
2. to limit imports of essential food items of which the domestic supply is adequate.
3. to reintroduce import substitution for the goods that can be produced by the local SMEs.
4. to attempt issuing long-term foreign currency denominated by sovereign bonds and not to obtain any more credit by the government from the domestic banking sector.
5. to start promotional programs internationally for Sri Lankan tourism, Sri Lankan tea, Sri Lankan garments, healthcare and education opportunities in Sri Lanka.
6. to suspend all household relief programs introduced during the lockdown season and not continue targeting at winning elections.
7. to introduce compulsory saving schemes for government workers at least for one year. This will save the government a total wage bill by at least by 5%.
8. to encourage telecommunications service providers to extend their services widely to the remote and rural communities.

The final conclusion is that many sectors are suffering from a short-term impact while a few of the sectors, such as travel and tourism, are in danger mid or long-term. Therefore, policy implications and regulatory industry/sector-specific measures must be designed and implemented while carefully investigating the interaction effect among different sectors of the economy.

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