LAKSHMAN KADIRGAMAR INSTITUTE
OF INTERNATIONAL RELATIONS AND STRATEGIC STUDIES

LKI EXPLAINER

The Future of Sri Lanka's Apparel Export Industry: *Brexit, the U.S. election and other key developments*

Ravindra Deyshappriya and Anishka De Zylva[1]

November 2016

[1] Research Director and Research Associate at the LKI. Dharini Vijendran, Research Assistant, and Mohamed Hasheem, Senior Programme Assistant, contributed to a prior version of this LKI Explainer, which was prepared at the request of the Ministry of Foreign Affairs. All errors and omissions remain the authors' own.

About the *LKI Explainers*
LKI Explainers examine an aspect of Sri Lanka's international relations. They summarize key issues and address new developments on these aspects, with up-to-date information, facts and figures.
Series Editor: Dinusha Panditaratne

Terms of use

Lakshman Kadirgamar Institute of International Relations and Strategic Studies
24 Horton Place, Colombo 7, Sri Lanka
Email: programmes@lki.lki. Website: www.lki.lk

Contents

We examine below recent developments that could affect Sri Lanka's apparel export industry, which accounts for over 40% of Sri Lanka's total exports. As the EU and US are the largest markets for Sri Lanka's apparel, we highlight the potential effects of Brexit, the regaining of GSP+, and the recent US Presidential election. We also summarize relevant proposals of the Sri Lanka Budget 2017, including those relating to the development of wearable technology, a global market that has been projected to increase threefold to USD 100 bn by 2023.

---

1. Brexit

- The UK receives just below 10% (USD 1 bn) of Sri Lanka's total exports, and 34% of its exports to the EU. Garments account for about 80% of Sri Lanka's total exports to the UK.

- The UK economy has been surprisingly resilient to Brexit so far, though mainstream economic analysis still predicts an impending adverse impact on the UK economy, which would thereby affect demand for Sri Lankan exports. Additionally, the tourism sector may be affected due to a depreciation in the value of the sterling pound.

- However, Brexit may also provide opportunities. Developing nations of the Commonwealth could urge the UK to introduce a preferential tariff system for Commonwealth countries. Sri Lanka could take the lead in negotiations for such a system. In researching the feasibility of the Commonwealth trade bloc, the LKI found data showing that when two trading partners are both Commonwealth members, their bilateral trade in goods and services is approximately 10% and 42% higher respectively, compared to trade between non-Commonwealth partners.

- Similarly, to mitigate the impact of Brexit, the Sri Lankan government has begun focusing more on the Asian region. Bilateral trade negotiations with China, India and Singapore have been initiated, with talks of negotiations with Bangladesh, New Zealand, South Korea and Thailand as well. Sri Lanka should naturally also initiate negotiations with the UK to facilitate access for its exports to the UK market after Brexit has been completed.

- Although the UK remains the single largest export destination for Sri Lankan apparel in the EU, the share of apparel exports to the UK has steadily declined since 2002. In particular, the share of apparel exports to the UK during 2000-2010 and 2011-2015 declined by 12% and 10%, respectively. Similarly, the annual growth of Sri Lanka's apparel exports to the UK is significantly lower than it is to other EU countries. Average annual growth rates from 2010-2014 for the UK, in comparison to other EU countries, were 0.8% and 11.5%, respectively. Other EU countries, as opposed to the UK, therefore appear better markets for Sri Lankan apparel in the future. (Verite Research, 2016)

2. Regaining GSP+

- The EU's GSP+ tariff concession allowed Sri Lanka to sell over 7,000 products to the EU countries tax-free, and the apparel industry was the single largest beneficiary of GSP+. However, in February 2010, the EU cited the Sri Lankan government's alleged human rights violations as cause for the suspension of the GSP+ tariff concession. As a result, Sri Lanka lost more than LKR 800 million annually through apparel exports, and some garment factories were forced to close as a result, resulting in over 10,000 apparel employees losing their jobs.

- Prime Minister Ranil Wickremesinghe travelled to Brussels, Belgium on 16 October 2016 for high-level discussions with EU officials on renegotiating the GSP+ benefits. He met the President of the European Commission, Mr. Jean-Claude Juncker, who acknowledged that the national Government formed by the two main political parties in Sri Lanka had steered the island nation onto the right path.

- A 4-member delegation of the European Parliament recently visited Sri Lanka, to study the progress of national reconciliation and other human rights issues. They stressed that "it is still early days but the trend is good." It is expected that a formal recommendation on Sri Lanka's application will be made to the European parliament by January 2017, and the final decision will be made in May 2017.

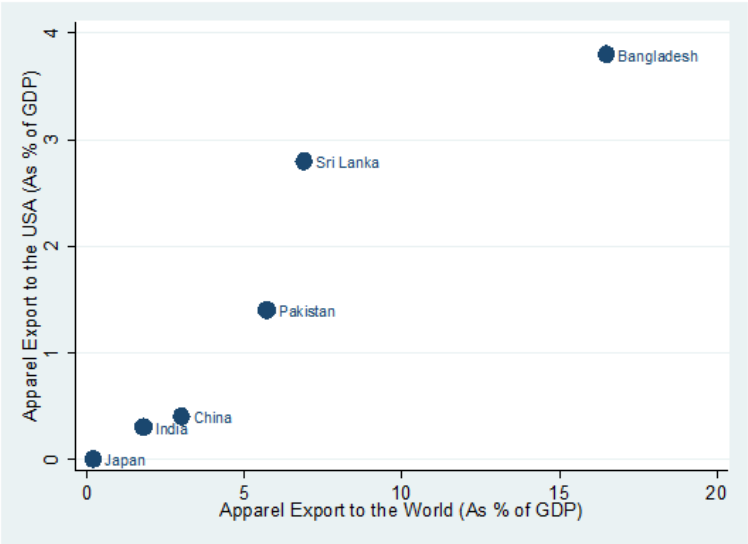
- If GSP + is not regained, it will be critical for the country to increase the quality of apparel exports, to increase competitiveness with countries like Bangladesh. It has been noted, however, that Brexit will somewhat lessen Bangladesh's current advantage in having GSP+.

- Some Sri Lankan apparel companies have begun operating in Ethiopia and Kenya, to obtain the duty free access to the US market provided to exports from Africa under the African Growth and Opportunity Act (AGOA). The purpose of this US legislation is to assist the economies of sub-Saharan Africa and improve economic relations between the US and the region. The AGOA may be considered a rival arrangement to GSP+, but it is a potential target of US President-elect Donald Trump.

3. The U.S. Presidential election

- The United States is the largest export destination of Sri Lanka and accounts for approximately 25% of Sri Lanka's exports. Moreover, over 70% of Sri Lanka's total exports to the US is in apparel, accounting for 43% of Sri Lanka's total apparel exports. Sri Lanka's apparel exports to the US account for a relatively high 2.8% of the country's GDP (Figure 01).

Figure 01: Apparel exports to U.S. and the World – Selected Countries



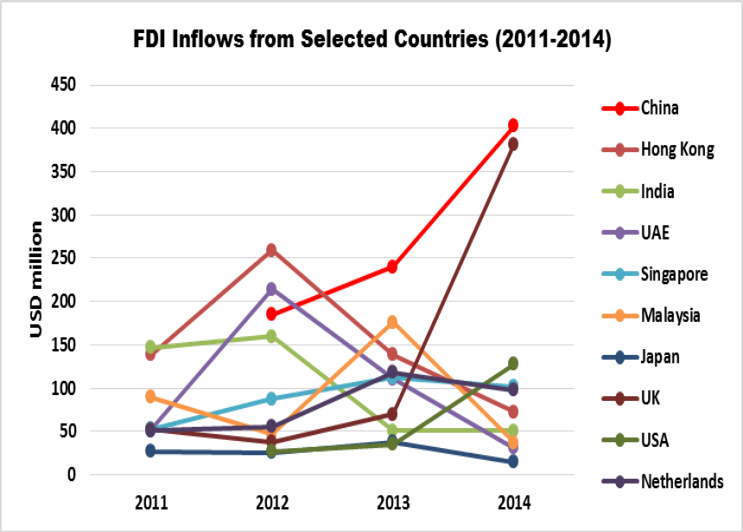
Source: Created by Ravindra Deyshappriya, based on data from World Integrated Trade Solution, 2015.

- Sri Lanka is therefore vulnerable to the current political changes and policy uncertainty in the US. It has been speculated that Trump's trade-skeptic policy could send the US economy into a recession and result in the loss of US jobs, which would lower demand for Sri Lankan apparel and other exports. The U.S. President has significant powers on trade matters, and President-elect Trump's Republican Party controls both houses of Congress. Unknown factors include whether implementation of his campaign rhetoric will be muted by political realities, and the potential influence of his key appointments.

- In addition, China and Singapore are major economic partners of Sri Lanka (and with whom Sri Lanka aims to negotiate FTAs). These countries appear especially vulnerable to the current changes and uncertainty in the US, due to the threat of the US imposing trade barriers on China and Singapore's high trade exposure (Singapore's exports to the US account for around 8% of its GDP).

- Given China is the largest source of FDI and 2nd largest source of tourists in Sri Lanka, and Singapore is one of the top 5 sources of FDI (see Figure 02), the vulnerability of the Chinese and Singaporean economies to US policy/markets has the potential to adversely impact the Sri Lankan economy as a whole.

Figure 02: Top Sources of FDI to Sri Lanka



Source: Created by Ravindra Deyshappriya, based on Board of Investment Annual Reports, 2011-2014
* Data not available for China in 2011

- A signature aspect of Trump's campaign platform was his promise to eliminate the Trans-Pacific Partnership (TPP), which has been pronounced dead since the US presidential election. In response, China has shown signs of seeking to negotiate a trade deal to replace the TPP. If this proceeds, Sri Lanka may wish to negotiate to enter the deal.

4. Other global developments

- China's dominance of the global apparel trade may change in the years ahead, mainly due to **rising prices in China** that are encouraging investors to seek out apparel companies in countries like Cambodia and Vietnam. A recent study by the World Bank suggests that a 10% increase in Chinese apparel prices will result in a 13–25 % (depending on the country) rise in apparel exports from South

Asian countries to the United States. This potential decrease in Chinese exports presents an opportunity for apparel sectors in South Asia.

5. Sri Lanka Budget 2017

The 2017 Budget proposals have the following expected positives.[*]

Expected positives for the **apparel** industry:

- The government will permit apparel companies in Sri Lanka to **invest** up to 5% of their average export turnover (of the preceding 3 years in any given year) **in overseas apparel-related entities**. Profits and income of such enterprises established overseas would need to be received by the investing company in Sri Lanka. (Page 37.)

- **Fashion Design will be a new subject** in the Ordinary and Advanced Level curricula. (Page 20.)

- 15 **export villages** will be created on a Public Private Partnership (PPP) basis, some of which will focus **on the apparel sector**. (Page 40.)

- Although the apparel and textile industry is a major foreign exchange earner at almost USD 4,800 million, Sri Lanka imported fabrics of almost USD 2,296 million in 2015. To support the necessary **backward integration**, the government has proposed the formation of a **textile cluster**, which will include sizing, dyeing and finishing units. It will provide relief to businesses that invest in the textile cluster, plus the required space. This aims to save at least USD 2,000 million per annum. (Page 40.)

- To create additional avenues for garment exports, permission will be granted to import manufactured branded products for **reworking**, under the commercial hub regulations. Such reworked garments would be exported to countries where there is no preferential treatment. (Page 40.)

Expected positives for the development of **wearable technology**:

- The government will allocate LKR 1.3 billion to facilitate **science, technology and innovation**, an increase from LKR 826 million in 2016. (Page 43-44).

- LKR 100 million each will be set aside for the **Innovation Accelerator Fund** introduced last year, the establishment of a **Biotechnology Innovation Park**, on a PPP basis, and to the **Center for Advanced Electronic Design** at the University of Moratuwa to support start-ups in niche electronic sectors. LKR 250 million will be allocated to the Sri Lanka Institute of Nanotechnology (SLINTEC) and LKR 50 million to the **Centre of Excellence in Robotics Applications**. (Page 44.)

- LKR 500 million will be allocated to entrepreneurs in **Product Design Engineering**. (Page 45.)

- To build relevant skills, **Digital Technology will be a new subject** in the Ordinary Level and Advanced Level curricula (Page 20-21.) LKR 100 million will be allocated to encourage students to pursue a **Bachelor of Education in Science, Technology** and other subjects to increase the number of teachers in these fields. (Page 25.)

[*] All page numbers are references to the 2017 Budget Proposals here.

Expected positives for **all export** industries:

- The Customs Department will publish the average **processing time of import and export documentation and average release time of goods**. It will ensure that (i) export documents and containers will be processed for shipment within 2 hours from time of submission, and (ii) import documentation will be processed in 3 hours, and containers released within 24 hours. (Page 92.)

- Initial steps will be taken for traders to **electronically submit required documents** or data to the relevant authority, for the import, export or transit of goods through a single entry point. (Page 92.)

- Exporters with an increase of 15% or more in **foreign currency earnings** for the year of assessment 2016/17 in comparison to 2015/16 will be granted a **rebate** equal to 75% of the tax attributable to the increased earnings. (Page 133.)

- To **attract high impact investments**, any domestic or foreign company investing USD 5-100 million (excluding the value of land) in Sri Lanka will be provided a grant of 5% of the investment at the end of its 2nd year of operation, if it engages in a venture with more than 40% value addition that could generate employment for 500 employees. If this is maintained for 5 years, the government will top up by a further 5%. It will also grant a 100% capital allowance on such businesses.

- For "Landmark Investments" of USD 100-500 million and over USD 500 million, the government will design special incentive packages with specific tax concessions. A 5-year multi-entry visa to these investors and their skilled expatriate labour has been proposed. (Page 36.)

- Among the **tax incentives to spur investment in the Northern, Uva and Eastern provinces**, the government has proposed a 200% capital allowance for businesses that invest in the Northern Province. For businesses investing over USD 3 million (excluding the value of land) and generating 250 employment opportunities in the Uva and Eastern provinces, the capital allowance would be 100%. A three or five year tax holiday could also be granted for businesses that create 500 or 800 new employment opportunities, respectively. (Page 36.)

- The government will commence operations of an **EXIM Bank** in 2017. It will have an initial capital of LKR 25,000 million, with an initial government contribution of LKR 10,000 million. (Page 39.)

- Small-scale and medium-scale entrepreneurs, including from the apparel sector, will be provided **concessionary loan schemes** based on turnover and employment generation capacity. The proposed allocation is LKR 750 million, including a 50% interest subsidy for SMEs with a turnover of LKR 25-250 million and an employment cadre of 10-50. Those with a turnover between LKR 250-750 million and employment cadre of 50-300 will be given an interest subsidy of 25%. (Page. 33-34.)

The 2017 Budget proposals have the following potential negatives.

- **Tax** on profits/income of export sector businesses will be revised from 10/12% to 14%. (Page 134.)

6. References

Amarasinghe, U. (2016). Touching the Heart, Business Today.
http://www.businesstoday.lk/article.php?article=10951

Central Bank of Sri Lanka. (2016). Statistics on External Sector: Exports – Annual (1990 – Latest)
http://www.cbsl.gov.lk/pics_n_docs/08_stat/_docs/xls_external_sector/table2.01.xls

ColomboPage. (2016). Sri Lankan PM in Brussels to renegotiate GSP Plus.
http://www.colombopage.com/archive_16B/Oct16_1476638323CH.php

Daily News. (2016). Sri Lanka – Bangladesh FTA by March?
http://dailynews.lk/2016/11/10/local/98771

Dias, K. (2016). PM talks with key factions representing European Parliament-focus on GSP Plus concession.
http://newsfirst.lk/english/2016/10/pm-hold-talks-key-factions-representing-european-parliament-focus-gsp-plus-concession/152257

Davis, B. (2016). Trump Trade Plan Could Push U.S. into Recession.
http://www.wsj.com/articles/trump-trade-plan-could-push-u-s-into-recession-study-says-1474257662

Frontpage. (2016). Brexit: The Impact on Sri Lanka.
http://www.frontpage.lk/page/Brexit-The-Impact-on-Sri-Lanka/11525

Jayaratne, G. (2016). Brexit Not to Have Significant Impact on Sri Lankan Economy: CBSL Governor.
http://www.chatter.lk/category/newsdetails/5/2333/brexit-not-to-have-significant-impact-on-sri-lankan-economy-cbsl-governor

Jayaratne, S., Hewage, K., & Sirisena, C. (2016). Brexit: The Not-So-United Kingdom, The Institute of Policy Studies.
http://www.ips.lk/talkingeconomics/2016/06/24/brexit-the-not-so-united-kingdom/

Kindergan, A. (2013). The Future of Wearable Technology.
https://www.credit-suisse.com/us/en/articles/articles/news-and-expertise/2013/07/en/the-future-of-wearable-technology.html

Lanka Business Online. (2016). GSP Plus final decision by May 2017, tangible progress needed: EU.
http://www.lankabusinessonline.com/gsp-final-decision-by-may-2017-tangible-progress-needed-eu/

Lanka Business Online. (2016). Sri Lanka-Thai FTA expected by middle of next year: Thai Commerce Minister.
http://www.lankabusinessonline.com/sri-lanka-thai-fta-expected-by-middle-of-next-year-thai-commerce-minister/

Lee. Y. H. M. (2016). How Many Trump products were made overseas? Here's the complete list.
https://www.washingtonpost.com/news/fact-checker/wp/2016/08/26/how-many-trump-products-were-made-overseas-heres-the-complete-list/

Martina. M. (2016). China pushes Asia-Pacific trade deals as Trump win dashes TPP hopes.
http://www.reuters.com/article/us-china-diplomacy-trade-idUSKBN1350S4?feedType=RSS&feedName=businessNews

Ministry of Finance Sri Lanka. (2016). Budget Speech 2017.
http://www.treasury.gov.lk/article/-/article-viewer-portlet/render/view/budget-speech-2017

Oxford Business Group. (2016). Sri Lanka's clothing industry looks to improve competitiveness.
http://nation.lk/online/2015/12/01/sri-lankas-clothing-industry-looks-to-improve-competitiveness.html

Parameswaran. P. (2016). What will Donald Trump's Asia Policy Look Like?
http://thediplomat.com/2016/11/what-will-donald-trumps-asia-policy-look-like/

Posner, E. (2016). Are There Limits to Trump's Power
http://www.nytimes.com/2016/11/10/opinion/are-there-limits-to-trumps-power.html

Premadasa, T.K. (2016). Brexit and Sri Lanka exports.
http://www.ft.lk/article/551475/Brexit-and--Sri-Lanka-exports

Radio New Zealand. (2016). Another Asia free-trade deal floated.
http://www.radionz.co.nz/news/political/314814/another-asia-free-trade-deal-floated

Razzaque. A., Ali.S.,Keane. J., & Gosset.L. (2016). The Rising Commonwealth Tide: Emerging Dynamics of Intra-Commonwealth Trade and Investment.
http://www.oecd-ilibrary.org/commonwealth/trade/a-rising-commonwealth-tide_5jm3mc9b4gzr-en;jsessionid=3oxt7kpin89n.x-oecd-live-03

Research and Markets. (2016). Wearable Technology 2016-2026.
http://www.researchandmarkets.com/research/svlpt6/wearable

Research Team. (2015). Renewal of US GSP: What It Offers Sri Lankan Exporters, The Institute of Policy Studies.
http://www.ips.lk/talkingeconomics/2015/07/14/renewal-of-us-gsp-what-it-offers-sri-lankan-exporters/

Schneidman, W. (2016). Donald Trump and Africa.
https://www.brookings.edu/blog/africa-in-focus/2016/11/10/donald-trump-and-africa/

Sri Lanka Apparel Exporters Association. (2016). Brexit to create level playing filed for Lankan apparel exporters.
http://www.srilanka-apparel.com/news-a/574-brexit-to-create-level-playing-filed-for-lankan-apparel-exporters

Sri Lanka Business. (2015). Exports to USA 2011-2015.
http://stat.srilankabusiness.com/epi2015/pdf/Pg(118-118)-%20Exports%20to%20U%20S%20A.pdf

Sri Lanka Export Development Board. (2016). Apparel Export Performance.
http://www.srilankabusiness.com/apparel/apparel-export-performance.html

Sri Lanka Foundation. (2016). Lankan Apparel Exporters See Opportunity in Brexit.
https://srilankafoundation.org/newsfeed/lankan-apparel-exporters-see-opportunity-in-brexit/

Swanson, A. (2016). Trump will have the power to move swiftly on trade.
http://www.chicagotribune.com/business/ct-trump-trade-deals-20161109-story.html

Sunday Times. (2016). ETCA talks next month, free trade deals with China, Singapore too.
http://www.sundaytimes.lk/160724/news/etca-talks-next-month-free-trade-deals-with-china-singapore-too-202306.html

Tatsumi, Y. (2016).Trump Wins: Implications for US Allies and Partners in Asia.
http://thediplomat.com/2016/11/trump-wins-implications-for-us-allies-and-partners-in-asia/

The Economist. (2016). what do the latest GDP data say about the post-Brexit economy?
http://www.economist.com/news/britain/21709342-post-brexit-gdp-figures-what-do-latest-gdp-data-say-about-post-brexit-economy

The Guardian. (2016). UK economy defies fears of slowdown after Brexit vote.
https://www.theguardian.com/business/2016/oct/27/uk-economy-defies-brexit-slowdown-fears

The Korea Times. (2016). Sri Lanka seeks to expand economic ties with Korea.
http://www.koreatimes.co.kr/www/news/nation/2016/02/634_197283.html

World Bank. (2016). Stitches to Riches? Apparel Employment, Trade, and Economic Development in South Asia.
https://openknowledge.worldbank.org/handle/10986/23961

World Integrated Trade Solution. (2016). Singapore Trade Summary 2015.
http://wits.worldbank.org/CountryProfile/en/Country/SGP/Year/2015/Summarytext

United States Government Publishing Office. (2000). Public Law 106-200.
https://www.gpo.gov/fdsys/pkg/PLAW-106publ200/pdf/PLAW-106publ200.pdf

Verite Research. (2016). Impact of Brexit on Sri Lanka.