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Impact of COVID-19 Response on Unemployment in Sri Lanka

ASIA'S PATH FORWARD

By Nishan de Mel and Mihindu Perera | 1 October 2020



INTRODUCTION

Goal number eight of the Sustainable Development Goals is set out as “Decent work and economic growth.” This goal recognizes that economic growth is not just an end, but also a means in itself of generating jobs – productive and meaningful work, an enduring measure of human development. Therefore, from a developmental perspective, it remains important to be vigilant not only about the impact on the economy but also about the creation of jobs and the extent of unemployment.

In Sri Lanka, the government’s response to COVID-19 was akin to a “crush and contain” strategy, wherein the country was placed on the most stringent curfew-level lockdown for a period of 52 days after the first case of COVID-19 was detected on March 11th, 2020.

Many Sri Lankan workers lost their jobs in the immediate aftermath of the lockdown. Statistics indicate that the total number of jobs in the economy contracted by 160,996 in the first quarter of 2020.

Consequently, the COVID-19 response in Sri Lanka has already had a large impact on economic growth. Furthermore, measures taken by the government to preserve foreign reserves has resulted in further restrictions to importations and investments, which in turn have an impact on economic growth. This article translates estimates on economic impact to estimates of impact on unemployment, as it arises in this context of containing COVID-19 in Sri Lanka.

The estimates indicate that following the curfew-level lockdown implemented in Sri Lanka between March and June 2020, overall unemployment increased to above 6% in the second quarter and will remain above 6% for the rest of the year. These estimates offer the government a means of evaluating some of the social and economic consequences that arise from curfew-level lockdowns, and point to the importance of developing more measured approaches of containing the spread of COVID-19, as the pandemic risks persist.

IMMEDIATE IMPACT OF COVID-19 RESPONSE

In March 2020, Sri Lanka rapidly adopted extreme lockdown measures to prevent the spread of the disease. Even though these measures were adopted only in the last 12 days of March, they had an immediate impact on unemployment metrics in Q1 2020 – it increased to 5.7%, up from the 4.5% of the previous quarter.¹ In the last 10 years, Sri Lanka reported less than 5% unemployment in every quarter

¹ Department of Census and Statistics. 2020. “Sri Lanka Labour Force Survey 1st Quarter - 2020.” http://www.statistics.gov.lk/samplesurvey/LFS_Q1_Bulletin_WEB_2020_final.pdf.

except for Q3 2019, following the Easter Sunday attacks.

The curfew-level lockdown continued for 40 days into the second quarter before being lifted on May 11, 2020. The impact on unemployment during this time could be quite severe, given that 24.8% of Sri Lanka's employed labor force report themselves as being daily wage earners.

YEAR 2020 IMPACT OF COVID-19 RESPONSE

Okun was the first to attempt to parameterize the relationship between economic growth and unemployment.² "Okun's Law" describes the theoretical approach to estimating the knock-on relationship between economic growth and unemployment.

The estimates for economic growth used in this article are drawn from de Mel and Kapilan (2020), which is also published in this series of Asia Path Forward as "Facing a Second Wave of COVID-19 in Sri Lanka: Economic Cost of a Lockdown Strategy."³ Those estimates for Sri Lanka's economic growth are bounded by an Optimistic and Pessimistic outlook. The estimated range is between an overall negative growth of -2.4% (Optimistic) and -6.4% (Pessimistic) for 2020. These estimates are also provided on a quarterly basis.⁴

Based on those estimates, our calculations find the unemployment rate in Sri Lanka increasing to 6.3%-6.9% in the fourth quarter of 2020 (see Exhibit 1).

OKUN'S LAW PARAMETER AND ESTIMATION METHOD

The underlying concept of Okun's Law is that any economic contraction will lead to an increase in job loss and therefore unemployment. The parameter that translates economic contraction to an increase in unemployment we will call the Okun's Law parameter.

There is a large body of literature and much theoretical innovation around the estimation of this parameter. Economists will find it helpful to know that through a regression model built on the first

² Okun, Arthur M. 1962. "Potential GNP: Its Measurement and Significance, Cowles Foundation Paper 190." Cowles Foundation, Yale University: New Haven, CT, USA. <https://mileskorak.files.wordpress.com/2016/01/okun-potential-gnp-its-measurement-and-significance-p0190.pdf>.

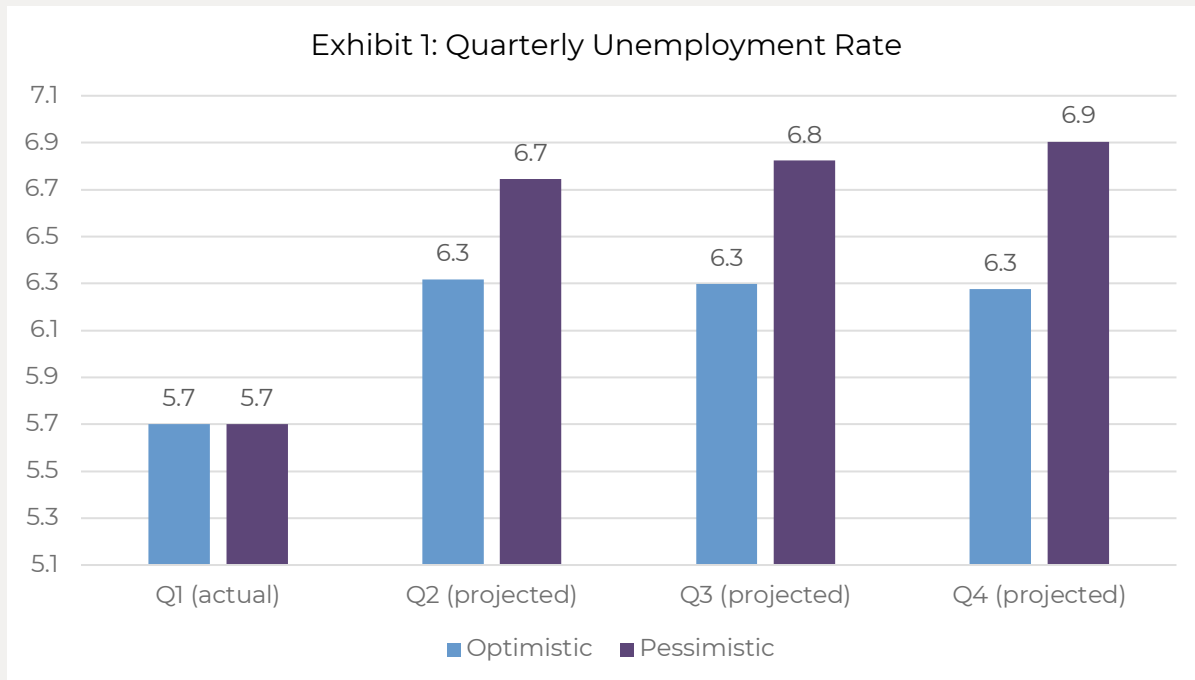
³ de Mel, Deshal, and Kapilan, Anushan. 2020. "Facing a Second Wave of COVID-19 in Sri Lanka: Economic Cost of a Lockdown Strategy."

⁴ Data was provided by the authors on request

differencing of the variables,⁵ we have arrived at an estimate that meets the requisite criteria of a stationary process. This keeps us firmly within the standard methodology of estimating the parameter. The regression was fed with Sri Lanka's quarterly GDP and unemployment data from 2003-2015.

The resulting parameter we estimate for Okun's Law in Sri Lanka is 0.052 – that is, when GDP increases by one percentage point, unemployment within that quarter decreases by 0.052 points. While this estimated parameter is relatively small, other studies on Sri Lanka do also show similar estimates.⁶

The estimation follows an iterative process through each quarter. We project unemployment for the second quarter, by first applying the Okun's Law parameter to the economic contraction/expansion from the first to the second quarter; and then adding that calculated change in unemployment to the unemployment level in the first quarter. This process is then repeated iteratively for quarter three and quarter four and the resulting numbers are set out in Exhibit 1.



⁵The regression model used is: $\Delta U_t = \alpha + \beta \Delta Y_t + \gamma \Delta U_{t-1} + t + \epsilon_t$ where U is unemployment rate, Y is GDP, t is the time period, delta (Δ) means "percentage change", and beta (β) is the Okun's law parameter that is being estimated.

⁶Prabagar, Shan. 2016. "Is Sri Lankan Economic Behaviours Consistent with Okun's Law?" *International Journal of Accounting and Business Finance*, no. 2: 46-54.

QUARTERLY ESTIMATES: OPTIMISTIC AND PESSIMISTIC

The present estimates for growth and unemployment outcomes for 2020 in Sri Lanka are based on the assumption that there will be no further lockdown in Sri Lanka as a COVID-19 response. The estimates have been developed for both an optimistic and pessimistic scenario to suggest that the final outcome would likely fall within a range between these two scenarios.

Optimistic Scenario: In the Optimistic scenario, GDP growth is expected to be negative by -11.7% in the first quarter, with minor positive growth of 0.4% for the third and fourth quarter. Consequently, unemployment is estimated to increase to 6.3% in the second quarter and remain at that level through quarter three and four. In this scenario, the annual average unemployment rate will be 6.2% for the year 2020.

Pessimistic Scenario: In the Pessimistic scenario, GDP growth is expected to be -19.8% in the first quarter and show a further negative growth of 1.5% for the third and fourth quarter. Consequently, unemployment is estimated to increase to 6.7% in the second quarter and continue to increase to 6.8% and 6.9% respectively in quarters three and four. In this scenario, the annual average unemployment will be 6.5% for the year 2020.

Even the Pessimistic scenario set out above, however, remains optimistic about Sri Lanka's present strategy of crushing and containing the spread of COVID-19, and is based on there being no further curfew-level lockdowns in the country for the rest of the year. If Sri Lanka moves to re-impose another severe lockdown in 2020, then these numbers would have to be re-estimated accordingly.

IMMEDIATE PRIORITY FOR SRI LANKA

The main reason that Sri Lanka had to adopt a curfew-level lockdown was because it presently lacks the legal instruments to implement appropriately calibrated social restrictions on the basis of a public health emergency. The ability to formulate such a regimen of restrictions was further impeded by the dissolution of Parliament on March 3, 2020 in preparation for the 2020 general election.

The General election has since been held on 5 August 2020, and a new parliament has been convened on 20 August. As the COVID-19 pandemic remains a global health emergency, Sri Lanka remains in need of legal and regulatory structures that allow the government to legally and democratically manage a COVID-19 type health emergency while minimizing the adverse impact to the economy.

Observation: It is the absence of such legal structures that resulted in curfew-level lockdowns between March and May 2020, which effectively shut down much of the labor market and destabilized the economy.

Analysis: The unemployment projections in this paper show that through the negative impact on growth, the level of unemployment in Sri Lanka will also rise significantly. This article has measured out the impact of the economy on unemployment to be to between 6.3 to 6.9%.

Implication: There is presently a risk of these consequences being exacerbated if the government goes back into another round of curfew-level lockdown without adequately calibrated lockdown measures to minimize the disruption to the economy and the labor market.

Recommendation: The Parliament of Sri Lanka can formulate and adopt the legal and regulatory tools needed to calibrate the management of a COVID-19 type health emergency, such that the above analyzed adverse impact to jobs and livelihoods is minimized in the future.

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