The Case for Liberalization of Tea Imports for Increasing Value Addition and Enhancing Tea Exports of Sri Lanka

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*The author benefitted from the research assistance of Anneke De Silva, Research Intern at the Institute of Policy Studies of Sri Lanka.
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by
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Abstract
Tea in its traditional form as a brewed beverage is undergoing change in the context of changes in consumer preferences and lifestyles and increasing competition from other beverages in the global market. As a result, the Sri Lanka’s tea industry is at crossroads and the country’s status as an exporter of bulk tea needs to be altered as an exporter of value added teas. This step forward amidst changes in the global market is essential for the future viability of the tea industry. However, stakeholders of the tea industry with diverse agendas are divided on this issue and as a result there is no clear policy direction for the value addition process of the tea industry. The paper argues that increasing exports of value added teas by importing teas and blending with local teas and then exporting these products as mixed blends will lead to a greater range of Sri Lankan tea exports, including “Pure Ceylon Tea”. Such a strategy would widen the existing consumer base for the Sri Lankan tea exporter allowing the industry to promote teas catering to diverse ranges of tastes and prices. Imported teas will not depress the prices for the local teas and mixed blends will not dilute the image of ‘Pure Ceylon Tea’ if statutory safeguards are in place. The paper presents the case for a gradual liberalization of foreign teas until the regulatory framework gets consolidated in the economic system.

1. Introduction

1.1 Background
The tea industry in Sri Lanka has been of vital importance to the country since its introduction by the British in 1867. Tea is cultivated in different districts in Sri Lanka, with variation in produce arising due to both regional and seasonal differences. The varying landscapes of the tea-growing regions facilitate the production of high, medium, and low grown teas; all of which have a distinct difference in flavour.² Sri Lanka exports the bulk of its tea production and the export practices that were inherited from the

¹ The author benefitted from the research assistance of Anneke De Silva, Research Intern at the Institute of Policy Studies of Sri Lanka.
² The high demand for low grown teas from the Middle East and Russia means that this variety currently fetches the highest prices (and has subsequently seen prices increase by 119 per cent over the period 1990-2001).
colonial rule still prevail, i.e., tea is exported mostly in bulk form to external markets so that marketing is done by the foreign buyers. Moreover, the British introduced auctioning system still prevails where tea supplies are purchased at the auction for exporting.

In the past, Sri Lanka has enjoyed recognition as the largest global tea exporter; with shares of 34 per cent of global tea exports in 1950 and 21 per cent in 1999. However, due to greater competition from producer countries, this share has continued to deplete, with the title of leading exporter being recently lost to Kenya who currently possess 22 per cent of global exports. Sri Lanka also faces tough competition from other producer countries such as Vietnam, China, and India.

It is not only external competition but also domestic factors that have contributed to the declining share in the global tea market. The industry has undergone a number of managerial changes over the years such as nationalization for two decades and re-privatization thereafter. Following nationalization in 1972/1975, the industry went through a turbulent period and a decision was made to place tea plantations under private management in 1992. However, the prevalence of the State as primary owners of the plantations meant that the associated benefits of privatization, such as higher productivity and output, were not realized. In order to remedy these distortions the government transferred the ownership (under a long-term lease) to the private sector in 1995, in the hope that it would lead to the desired increases in productivity and output. Since then, there has certainly been improvements in tea production and exports but Sri Lanka still performs below its potential.

The somewhat archaic structure of Sri Lanka’s tea industry has been criticized and blamed for the gradual decline in the country’s share of exports. The criticism targets both production and exports. With regards to the former, the industry harbours the highest production costs among its competitors with labour amounting to 66 per cent of production costs. Continual government intervention with wages prevented managers basing employees’ pay on productivity. This in turn distorted the incentive structure of
the wage system which was one of the causes for the persistent low productivity (Kelegama, 2010). There is also a reported lack of modernization in production practice which makes it difficult for the industry to compete with other countries employing more capital intensive methods of production.

With regard to exports, the main criticism lies with the industry’s main produce, viz., bulk tea. Sri Lanka exports 90 per cent of its production of which, in 2002, 59 per cent was bulk tea. Bulk tea refers to Ceylon tea sold in its purest form without any additional value added to it. This tea is traded by exporters at tea auctions and purchased by local and foreign companies that will go on to add value to the product, such as blending or producing tea bags, before re-selling as a final good. However, competing countries such as Kenya and India have moved from simply trading tea to marketing tea with greater investment in the export of value-added tea, i.e., exporting a final product. Hence, with competitors diversifying output in this manner, questions are being raised as to whether or not, Sri Lanka should be doing the same in order to reclaim the share of the global market that has already declined.

1.2 Current Performance of the Tea Industry

The Sri Lankan tea industry is currently the third largest export sector in the country, accounting for over 13 per cent of total export earnings in 2009. Between the period of 2002-2009, the tea sector’s share of GDP has remained relatively stable, as illustrated by Table 1.1.

<table>
<thead>
<tr>
<th>Year</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tea</td>
<td>1.4</td>
<td>1.3</td>
<td>1.4</td>
<td>1.2</td>
<td>1.1</td>
<td>1.4</td>
<td>1.3</td>
<td>1.5</td>
</tr>
</tbody>
</table>

**Source:** Summary Indicators (2009: 3rd Quarter), Department of Census and Statistics, Sri Lanka.

Along with this steady share of output in recent years there has been an increase in the demand for low grown teas amongst consumers in Russia and the Middle East (Table
1.2). The popularity of this particular variety of tea comes from the preference for the dark colour and comparatively delicate flavour of the low growns amongst the Russian and Middle Eastern consumers. The consumption from these low grown teas makes up 78 per cent of Sri Lankan tea exports. Subsequently, low grown teas receive the highest prices when traded at the Colombo Tea Auctions (Figure 1.1).

### Table 1.2: Main Destinations of Ceylon Tea: 2008 and 2009
(Quantity in Mn. Kgs.)

<table>
<thead>
<tr>
<th>Country</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Russia</td>
<td>45.43</td>
<td>42.40</td>
</tr>
<tr>
<td>UAE</td>
<td>45.16</td>
<td>30.94</td>
</tr>
<tr>
<td>Syria</td>
<td>26.14</td>
<td>29.50</td>
</tr>
<tr>
<td>Iran</td>
<td>31.04</td>
<td>27.75</td>
</tr>
<tr>
<td>Turkey</td>
<td>15.86</td>
<td>15.72</td>
</tr>
<tr>
<td>Jordan</td>
<td>14.30</td>
<td>13.40</td>
</tr>
<tr>
<td>Kuwait</td>
<td>7.53</td>
<td>10.11</td>
</tr>
<tr>
<td>Iraq</td>
<td>11.65</td>
<td>9.85</td>
</tr>
<tr>
<td>Japan</td>
<td>10.25</td>
<td>9.51</td>
</tr>
<tr>
<td>Libya</td>
<td>7.24</td>
<td>8.11</td>
</tr>
<tr>
<td>Total</td>
<td>214.60</td>
<td>197.29</td>
</tr>
</tbody>
</table>

Source: Sri Lanka Tea Board.

Despite this seemingly positive outlook, the industry suffers from a number of inefficiencies in production and, when compared to rival producer countries, continues to under-perform. As stated, the production costs within the Sri Lankan tea industry are some of the highest in the global market. Given the labour-intensive nature of production, the highest cost accrues to labour. As evident in Table 1.3 these costs continue to rise. Despite this high cost in labour, as stated, productivity is reportedly low due to a number of factors (Kelegama, 2010).
The apparent caveat with relying heavily on Middle Eastern and Russian consumers for exports is their evident price sensitivity. Hence, exports of bulk tea to these areas will be subject to fluctuations in income. In order to make exports robust to such trends in income, thus minimizing the impact of global income trends on exports, the tea industry needs to tap into a market with greater price inelasticity. The argument for increasing the exports of value-added goods stems from this rationale, with many of the belief that through exporting final products the industry can acquire a more loyal, price inelastic, consumer base.
The Sri Lankan economy is dependent on the success and longevity of the tea trade, given the large number of people employed in tea production, which stood at 4.2 percent of the labour force in 2000. Given the persistently high degree of poverty in the estate sector, the industry cannot afford to ignore the need to modernize methods of production in order to compete with other, increasingly innovative, producer countries.

1.3 Objectives
The objective of this discussion is to decipher whether or not, value-added exports would benefit from liberalizing the imports of orthodox teas. In order to assess this issue, the arguments both for and against liberalization are presented. Within a liberalized framework, the role of government policy in the context of the value-addition process of tea is made so as to gain further insights to the liberalization framework’s sustainability. Concluding remarks are then made with recommendations for policy.

2. The Impact of Liberalizing the Import of Orthodox Teas on Value-Added Exports

2.1 The Significance of Value-added Exports
Value-addition refers to the process by which value is added to a raw material so that the good is closer to, or is, a finished product before entering the market. With regard to value-added tea, manufacturers may add value by blending and packaging the tea before selling it to consumers. In contrast, the sale of bulk tea is Ceylon tea in its purest form, with no additional value added to it. Such tea is purchased at the Colombo Tea Auctions and transported elsewhere to be modified into a final good before re-selling to consumers.

The increasing number of producer countries that have invested in value-added production has augmented the competition facing exports of Ceylon tea. The greater competition comes from the ability of producers of value-added goods to supply the market with cheaper exports of tea. This is facilitated by the prior blending (value-addition) of the locally produced orthodox teas with imports of cheaper orthodox teas.
Two such countries employing these methods are Kenya and India, the former of whom has recently managed to overtake Sri Lanka as the largest global exporter of tea.

Both Kenya and India have liberalized the imports of foreign teas in order to pursue the value-addition and re-export of comparatively cheaper goods. The liberalization of imports allowed the Kenyan tea industry to extend their consumer base to the more price-sensitive markets in Somalia, Sudan and Yemen, whilst maintaining the export of pure Kenyan tea to loyal consumers in the UK and Egypt. India liberalized the import of loose teas, tea packets and tea bags in 1993 for value-addition purposes. In order to protect local producers from export substitution, the abolition of import restrictions was twinned with a minimum local content requirement in value-added re-exports.

In addition to the heavier rivalry from producer countries, Sri Lanka is also facing competition from non-producer countries. International blending centres have been established in London, Rotterdam, Dubai and Hamburg wherein tea is imported in bulk form, blended and then re-exported. This has heightened the pressure for the greater provision of value-added exports, as such centres threaten to dig further into Sri Lanka’s diminishing market share.

The low productivity and greater threat from competitors is reflected in the decline of Sri Lanka’s share in the world export market over the period 1980-2001. In contrast, Kenya managed to increase its share within the same period. Such figures suggest a degree of complacency surrounding Sri Lanka’s tea trade which has left the industry defenceless against growing competition. This complacency stems from the previous popularity of Ceylon tea amongst consumers in Western Europe. However, one cannot expect the past reputation of Ceylon tea to carry the whole industry in the present day.

In recent times consumer preferences have changed in favour of more convenient products, such as tea bags and instant teas. The majority of consumers are less likely to want to make decisions on the type of tea they are consuming; instead, consumers are more concerned with quality and reliability. This is evident in the rise in consumption of
branded products. Brand names guarantee a good quality product, making all the decisions on tea origin for the consumer. The market for pure teas, such as “Pure Ceylon Tea”, is considered a niche market occupying only 10 per cent of the global market, hence the loss in market share of Sri Lankan tea. It would appear that the tea industry needs to restructure their production in order to remain competitive with greater diversification of exports, in particularly into the export of value-added teas.

The complete reliance on auctions for the sale of bulk teas is another factor that may be adding to the uncompetitive aspect of Sri Lanka’s tea industry. The auction system gives no prior indication as to the exact demand for the good. As a result, the supply of bulk teas often exceeds the demand. Not only does overproduction dampen prices, it is also a waste of resources. In contrast, private sales hold the potential for greater efficiency as the exact volume to be purchased is predetermined, ensuring that supply meets demand. Contact with buyers also enables producers to remain competitive through their greater knowledge of consumer tastes and preferences.

2.2 The Rationale behind Liberalizing Imports: Exporters’ Perspective

The import of orthodox teas is currently restricted in Sri Lanka. However, the import of CTC (cut, tear, curl) teas (required for the production of tea bags) and specialty teas is permitted for the purpose of value addition due to a lack of domestic production. The removal of import restrictions on orthodox teas is a mooted point; with exporters in favour of liberalization and producers strongly against it.

One of the main benefits of liberalization, as proclaimed by exporters, is the ability to blend cheaper imported orthodox teas with local teas so as to reduce the Free on Board (FOB) price of the teas. A lower FOB price increases the competitiveness of the product and the likelihood that the good will be successful in the market.

Conversely, if value-addition is to be completed using only domestic tea, inputs may be more expensive, thus decreasing its profitability. The large number of tea-growing districts in Sri Lanka is another factor that exporters claim will impede the quality of the
tea given the seasonal and geographical variations in taste. The droughts experienced in 2000 led to a decline in output of 3.5 per cent over the period 2000-2001, due to the high reliance on the production of low grown teas which accounted for more than 56 per cent of output. However, if imports are used to blend the tea, such agro-climatic conditions related fluctuation of supply will not arise.

Blending Ceylon tea with other origin teas and supplying it at lower prices will cater to the price-conscious consumer, owing to the ability of the blender to obtain different prices for different grades of teas, which will lead to an increase in the consumer base for Sri Lankan tea and thus export revenue. Blending local teas with foreign teas to obtain a consistent blend also minimizes fluctuations in quality, which not only facilitates brand promotion but also increases the range of tea blends that can be exported.

The prospect of forward integration is another facet of value-added production advocated by exporters. Expanding into value-addition brings producers the opportunity to gain from production further along the value-chain, thus increasing employment opportunities and encouraging growth in linking industries (such as packaging, shipping, banking, transport and advertising). Greater value-addition will eventually increase net export earnings and stimulate overall economic growth. In 2000, the Central Bank of Sri Lanka reported that value-addition activity in plantations was responsible for 2.5 per cent of GDP, 13 per cent of the labour force, 16 per cent of total export earnings and 73 per cent of total agricultural export earnings. Such figures indicate the potential that expanding the exports of value-added goods has on the economic growth of the country.

As we can see from Table 2.1, within the plantation sector (tea, rubber and coconut production) value-added activity in tea production contributed the most to GDP in the period 1998-2002. Compared to both coconut and rubber production, value-added production in the tea industry demonstrated a relatively stable contribution to GDP,
despite a slight dip in 1999 and 2001. Given the high number of labourers dependent on the plantation sector, it is important to expand production where possible.

Table 2.1 Share Percentage of Value-added Activity in Agricultural GDP

<table>
<thead>
<tr>
<th></th>
<th>1998</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tea</td>
<td>12.5</td>
<td>10.0</td>
<td>12.0</td>
<td>11.3</td>
<td>11.3</td>
</tr>
<tr>
<td>Rubber</td>
<td>2.2</td>
<td>1.6</td>
<td>1.7</td>
<td>1.4</td>
<td>1.7</td>
</tr>
<tr>
<td>Coconut</td>
<td>10.2</td>
<td>10.8</td>
<td>8.1</td>
<td>8.7</td>
<td>10.9</td>
</tr>
</tbody>
</table>

Source: Department of Census and Statistics, Sri Lanka.

The presence of continued value-added production in the tea sector indicates that the foundations for further expansion of value-added exports already exist. However, the lack of growth of share in GDP also suggests that value-added activity may become stagnated given the current policy of import substitution. Exporters argue that the greatest augmentation of value-added exports can be realized given the liberalization of imports.

2.3 The Case for Protectionism: Producers’ Perspective

Despite the seemingly positive impact that the liberalization of imports would have on the economy, there are a number of apprehensions expressed mainly by producers of bulk teas. The grievances of producers tend to regard the effect that liberalization would have on the competitiveness of local bulk teas in both the domestic and international market. Producers fear that the relatively cheaper blended teas will attract a higher demand amongst consumers at the auctions leading to a reduction in the price of local bulk teas.

Producers are also concerned about the effect that liberalization will have on the reputation of pure Ceylon tea. The presence of multi-origin teas in the Sri Lankan market may weaken the brand-image of Ceylon tea, reducing the marketability of pure Ceylon tea. This is based on the assumption that both value-added exports and bulk tea exports cater to the same market. However, pure teas are often regarded as a niche
commanding only 10 per cent of the global market. Therefore, it is improbable that blended re-exports will target the same market as exports of pure Ceylon tea and, hence, incidents of export substitution are unlikely to occur.

Furthermore, this concern of producers raises questions about the brand-power that “pure Ceylon tea” commands. Due to poor regulations on the usage of the “Pure Ceylon tea” name and lion logo, the reputation of this brand may already be diluted, as companies are able to label blended teas as such regardless of the actual content of Ceylon tea in their product.

It would appear that suppliers of bulk teas cater to two different markets; the connoisseurs and the brand-conscious. The former may not be affected by the greater provision of blended teas in Sri Lanka; however, the latter may be, due to their lower regard for the tea’s origin.

Local producers argue that due to the negative impact that the years of nationalization has had on the tea industry, it should be regarded as an ‘infant industry’ and thereby protected from outside competition until better established. This argument is often regarded in the literature as lacking credibility as the industry was introduced into the country over 100 years ago and above all the status of the Sri Lankan export share in the world market is well known. In addition, the tea sector experienced increased productivity in the immediate aftermath on the privatization of management in 1992, which directly contradicts the initial loss making characteristics of the traditional infant industry argument.

Producers are also doubtful over their capacity to gain from a policy of liberalization, owing to resources constraints restricting their ability to compete with other manufacturers of value-added exports in the global market. Such obstacles can be overcome through merging with established producers of value-added goods. Established producers possess superior market knowledge and strong relationships with

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3 The producers argue that the considerable resources and marketing skills possessed by multinational firms is no match for smaller local firms operating in the Sri Lankan industry.
suppliers and consumers that new manufacturers lack. An example of a domestic firm who has merged with an established producer, in order to capitalise on their marketability, is Indian company Tata Tea Ltd. who joined forces with Lyons Tetley’s group in 1994. The success of the venture enabled Tata Tea to eventually buy out Tetley’s distribution network in February 2001, thus augmenting their global share.

It must be noted that there are a number of local tea exporters who have overcome this resource constraint and ventured successfully into marketing of tea, such as Euro Scan Export Pvt. Ltd, Mlesna Tea and Dilmah marketed by the M.J.F. Group Pvt. Ltd (IPS, 2000).

However, mergers such as that experienced by Tata Tea Ltd. may not always result in such a favourable outcome for the domestic firm. Local producers, and the governments within which they operate, should exercise caution when dealing with transnational corporations whose market and political dominance may overbear decisions made by domestic affiliates.

The apprehension expressed by producers is based largely on past experiences of liberalization in Sri Lanka between 1981-89. In 1981 the government relaxed restrictions on all imports of tea with the intention of transforming Sri Lanka into a centre for tea trading. The removal of import barriers enabled the production of various value-added teas for exporting. Despite the regulations imposed in 1984 enforcing producers to specify the nature of the teas’ origin (“A blend of Ceylon and other teas packed in Sri Lanka” or “Imported tea packed in Sri Lanka”) the entry of imports of orthodox teas was blamed by tea producers for the reduction in the domestic price offered for local teas and as a result import regulations were reintroduced.

It should be noted that the price received for Sri Lankan tea is largely determined by world demand and supply conditions – it is dependent on the volume of tea produced and traded by the other tea producing nations in the world, such as India and Kenya. Also, it is difficult to make a generalized statement on the price of Sri Lankan tea in the
world market since the price received for a particular type of tea tends to vary with the
type of consumer market, the process of manufacture and different grades of teas in Sri
Lanka. An IPS (2000) study that looked at the implications of liberalizing imports of
orthodox teas strongly suggests that declining prices experienced by local tea producers
correspond to periods of over-supply in the domestic producer markets, with little
correlation of the import policies of the government.

Producers may be using this past experience of liberalization to make predictions on
present day prospects. However, as with all past experience, a paradox of thrift exists
meaning that past outcomes are conditional upon a multitude of factors in the past
which cannot be replicated today; hence, if the same policy was implemented today we
should not take for granted that the same outcome would be realized.

3. Policy Implications

The arguments presented thus far have highlighted both the motivation for liberalizing
imports of orthodox teas and the justification behind continued protectionism. It is
apparent that liberalization must be accompanied by a number of regulatory measures
in order for the policy to realize an increase in value-added exports with minimum
damage to local producers.

The role of the government in implementing supporting policies to facilitate the success
of liberalization is tantamount to its success. The task for the government is two-fold:
guiding first-time producers of value-added exports whilst helping to strengthen the
brandability of Ceylon tea.

Firstly, the government must support those firms venturing into value-added tea
exports by allocating resources towards research and development. The tea cess funds
can be effectively used for this purpose. It is vital that producers have good information

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4 There is criticism in the tea industry that the tea cess goes to the Consolidated Fund in the
Treasury and is being used for other purposes without channelling it back to the industry.
on their target market so as to avoid incidences of market failure. Innovation must be encouraged amongst both old and new producers so that they can capitalize on the tastes and preferences of the modern-day consumer. Owing to the generally more health-conscious pool of consumers, tea holds great potential for being marketed as a healthy alternative to many other beverages. If producers are able to tap into the market for health drinks, or instant drinks they stand to profit greatly.

Following this, the government must also support those firms producing pure Ceylon teas as a value-added final product. The greater marketing of pure Ceylon tea will help to secure its position in the niche market so as to maintain a loyal consumer base. In turn, this should work to secure its premium price in the market for bulk teas, so as to avoid the risk of blended teas acquiring the consumer base of pure Ceylon teas.

It is important to ensure that there is greater transparency for the consumer on the content of teas produced in Sri Lanka. This refers to the labelling of Ceylon teas which should specify the origin of the tea in order to reduce the occurrence of export substitution amongst consumers of pure Ceylon tea.

So as to protect local producers from export substitution in the value-added market, the government should follow suit of India and enforce a minimum local content requirement on such producers. This will help to ensure that all producers stand to benefit from the economic activity accruing from liberalization, so as to maximize the welfare to society. Without this minimum content requirement, producers of value-added teas may mix little Ceylon tea with large amounts of cheaper orthodox imported teas, for example, from Vietnam and China.

In short, the policy should be: (a) implementation of clear and precise laws applicable to labelling these new products for the export market in order to facilitate easier consumer choice, and (b) prescription of a minimum local content requirement for these mixed blends, which must recognize the need to ensure the quality of the re-export product.
The government must also encourage producers to invest in more environmentally friendly methods of production. The environment is a key concern of the international community and so it is important to establish greener production where industry is new and yet to invest in heavy capital. The government could subsidize such investment in order to encourage firms to uptake greener methods of production. Whilst benefitting society as a whole, producers can also use their endorsement of green production to attract the growing number of environmentally-aware consumers, thus further endorsing the image of Ceylon tea within the global market.

However, it is unlikely that the government would be able to simultaneously fund and oversee all of the discussed policies. Therefore, the process of liberalization should be a gradual one. This could be achieved by choosing to support a few producers of value-added exports, making imports of orthodox teas available exclusively to them. This would give the government a longer time-span, and subsequently increase the resources, with which they can gradually implement the necessary policies to safeguard the production of domestic tea whilst increasing the provision of imports to producers of value-added exports. However, such a tactic requires a high degree of discipline on behalf of the government to make sure that they remain committed to the goal of increasing the production of value-added exports and, hence, eventually liberalize imports to all producers. If the government loses sight of this intention, they may encourage the growth of monopolies in the industry amongst who would harbour a great number of inefficiencies.

One must also consider whether or not, current institutions are robust enough to regulate and oversee the implementation of new policies. The ability to gradually introduce liberalization into the economy will depend on the competence of regulatory bodies to supervise the long-term strategy of the government, so as to avoid plans being undermined by the private sector. Hence, the government may also have to strengthen institutions before commencing with liberalization policies.
4. Conclusions

In trying to resolve the ongoing debate, concerning whether or not imports of orthodox teas should be liberalized, the perspectives of both producers and exporters should be closely assessed in order to decipher how best such a policy can be introduced with minimum damage to the economy.

The Sri Lankan tea industry currently holds the third largest share within the export sector (after ready-made garment exports and remittances) and in 2009, was responsible for 13 per cent of export earnings. Furthermore, the sector has demonstrated a relatively stable share of GDP over the last 7 years. Such figures indicate the importance of the industry to the Sri Lankan economy.

The need for the restructuring of production and output has become apparent in recent years given the increased competition from producer countries, such as India and Kenya, and the rise of international blending centres amongst non-producer countries. This has called for greater investment into the diversification of produce within the tea industry, given changes in consumer preferences and the diminishing share of pure teas in the global market. Increasing the production and export of value-added goods is at the forefront of this agenda. In doing so, the country will stand to reclaim some of its lost global market share. The price-sensitivity of bulk tea consumers in the Middle East and Russia, to whom the industry supplies 78 per cent of exports to, has heightened the need to find a more price-inelastic consumer-base. In the contemporary policy debate in Sri Lanka, the disagreement stems from whether or not, imports of orthodox teas should be liberalized in order to increase the value-added exports.

Exporters within the industry proclaim that through liberalization the exports of value-added teas can be maximized given the provision of cheaper orthodox teas used for blending which will enable exporters to reduce the FOB price of their teas. The use of foreign teas in blending will enable producers to control for variations in agro-climatic conditions which affect the taste consistency of locally grown teas. This consistency in produce will increase the brandability of the value-added exports, thus increasing
competitiveness amongst brand-conscious consumers who seem to make up the majority of the global market.

Increasing the export of value-added teas will result in a number of macroeconomic benefits. These include greater employment, increased foreign exchange and the potential for strengthening industrial clusters in the economy via forward and backward integration. If imports are liberalized, then these benefits to society stand to be maximized, as a result of the increased global competitiveness of value-added teas that liberalization will facilitate. Furthermore, given the greater income of the private sector, plantations may be able to invest more into their human capital, increasing the overall welfare of poor plantation workers whilst reducing the need for government intervention in wages. Higher profit margins will also enable the private sector to invest in more efficient and environmentally-friendly methods of production. Such investment will be imperative to the survival of producers who, following the reduction in protection and participation in the value-added market, will be facing greater global competition.

It would appear that the liberalization of imports is an essential prerequisite to increasing the export of value-added goods. The inefficiencies harboured within the industry, as a result of ongoing protection, stand to only impede the ability of the country to compete in the global market for value-added exports. However, before proceeding with a policy of liberalization, the government needs to consider the requirements of bulk tea producers whilst assessing the ability of its institutions to oversee the transition.

The government will have to work with existing producers to encourage and fund greater marketing of the niche products; pure Ceylon tea. This will help to strengthen the reputation of Ceylon tea so that it is not negatively affected by the greater provision of blended teas in Sri Lanka. Through investing into marketing, the government can help to create two separate markets (segmented markets) for producers of pure Ceylon tea and producers of value-added teas, with the latter aimed at the brand-conscious
consumer and the former at the connoisseurs. Safeguarding the reputation of pure Ceylon tea in this manner indirectly protects producers of bulk tea by maintaining a market for those that want to capitalize on the tea’s success. To further protect producers of bulk tea, the government must impose minimum content requirements on producers of value-added goods to reduce the chances of export substitution.

Sri Lanka’s tea sector cannot be classed as an infant industry, due to its 100 year existence in the country. However, liberalization should be gradually introduced to the sector until the regulatory and most importantly the enforcement frameworks, are fully in place. Initially, the liberalization policy should be such that only a few market leaders gain access to the cheaper imports. Such a method would enable the government to strengthen the institutional framework so that as liberalization is deepened, the government has the ability to regulate the industry. This would also give local producers the time to become more efficient and, hence, more competitive in the rising face of foreign competition. However, the government must be careful not to unnecessarily prolong the provision of imports to the few chosen producers as they may inadvertently increase the barriers to entry within the market for value-added exports thus creating a monopoly situation.

All in all, in the face of a steadily increasing cost of tea production resulting in Sri Lanka’s share of world tea slipping down, the persistence of Sri Lanka’s current status quo as a bulk exporter of pure teas needs re-thinking. In addition, the vulnerability of the local tea industry to international shocks and crises has emphasized the need to focus on a long-term strategy that guarantees stability to this vital industry. An important dimension in this long-term strategy should be a movement towards value addition by promoting a range of Sri Lankan tea blends for the export market and for this purpose, the liberalization of foreign teas within a regulatory framework will definitely contribute.
References


Web References