Sri Lankan government announces tax hikes before IMF loan talks

Saman Gunadasa
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Sri Lankan Prime Minister Ranil Wickremesinghe announced tax increases to reduce the country's budget deficit in a special statement to parliament last Tuesday. The measures, which will impact heavily on the living standards of workers and the poor, appear to have been implemented on the instructions of International Monetary Fund (IMF). An IMF team is due to visit Colombo this month for talks on a $US1.5 billion loan requested by the government to avert a balance of payment crisis.

Wickremesinghe's central proposal was to hike Sri Lanka's value added tax (VAT) from 11 percent to 15 percent. This will drastically increase the prices of every commodity and service.

In an attempt to deflect opposition, the prime minister said the increase would not apply to essential items. Apart from telecommunications and private education institutions, he failed to specify any other exemptions. More than 80 percent of Sri Lanka's total tax income already comes from indirect taxes, which hit the poor hardest.

Other measures include the continuation of the Nation Building Tax (NBT) at 2 percent and reduction of tax's threshold from 3.75 million rupees ($25,950) to 3 million rupees to include more businesses. The NBT is meant to be paid by businesses but in reality is passed on to consumers.

Non-corporate and corporate income tax is to be kept at 17.5 percent for another year, despite promises in last year's budget to reduce it to 15 percent. The prime minister told parliament there would be a capital gains tax, ridiculously claiming it was a tax on "capitalists." He did not say, however, what the percentage was.

Wickremesinghe said the tax measures would reduce the budget deficit to 5.4 percent of GDP, from 5.9 percent. The truth is that to lower the deficit by half a percent, the government will have to implement major cuts in public expenditure. Moreover, the IMF wants the deficit reduced to 3.5 percent by 2020. Wickremesinghe said there would be more talks with IMF on further changes to the tax system in 2017.

The way the special economic statement was developed and announced not only indicated IMF involvement but produced crude attempts by the government to hide this fact.

On March 2, Finance Minister Ravi Karunanayake presented a document to cabinet on which the government's statement would be based. President Maithripala Sirisena, however, criticised the cabinet paper, saying its wording was similar to the IMF that the opposition would accuse the government of dancing to the IMF's tune.

The Colombo-based *Sunday Times* reported that Sirisena ordered all copies of the document to be collected and that cabinet members should not reveal its contents. On March 4, Wickremesinghe presented the same proposals in a nine-page document entitled, "Minimising the impact of the global economic downturn on Sri Lankan economy."

In his statement to the parliament, Wickremesinghe blamed Sri Lanka's debt problems on the former Rajapakse government and the global economic crisis. Rajapakse, he said, had put Sri Lanka in a "debt trap."

Wickremesinghe declared that total outstanding government debt at the end of 2015 was 9.5 trillion rupees ($65.6 billion) or about 75 percent of the gross domestic product (GDP), including loans by the Ceylon Petroleum Corporation, Sri Lankan Air Lines, Sri Lanka Ports Authority and other state enterprises. Sri Lanka's debt servicing payments for 2016, he said, had increased to 1,209 billion rupees.

The prime minister said the economic slowdown in China and Russia, and the escalating geo-political crisis in the Middle East was impacting on tea exports, tourism and overseas workers' remittances. He warned that an interest rate hike in the US and Britain's possible exit from the European Union would impact on the economy and make it harder to obtain cheap loans.

Wickremesinghe's comments on the growing debt burden are hypocritical. The debt crisis is not simply a product of the Rajapakse government. It is driven by global processes and the cost of increased military spending by successive Sri Lankan governments during their 30-year war against the separatist Liberation Tigers of Tamil Eelam.

The government's new taxes and cost-cutting measures have been developed on the direct orders of international finance capital.

Wickremesinghe admitted to parliament: "We discussed the crisis situation with IMF managing director Christine Lagarde, economists such as George Soros, Joseph Stiglitz and Ricardo Hausman, and listened to their advice. Their opinion was that it was very difficult to predict the world economic situation and [they] advised us to put more weight on increasing national income with utmost care in spending."

Just as the European banks and the IMF demanded in Greece, this "advice" means pauperising the working class and the oppressed masses by slashing jobs, wages and all social gains.

Colombo is desperate to obtain an IMF bailout loan. When the Sirisena-Wickremesinghe government came to power early last year it immediately sought IMF funds. These appeals were turned down by the IMF, which said Colombo had not met its budget targets and failed to restructure and privatise the public sector.

Some of the IMF's proposals, however, were implemented, including the abandonment of Central Bank interventions to determine the Sri Lankan rupee's exchange rate. This has resulted in a devaluation of the rupee by more than 10 percent since the Sirisena government took office.

The value of exports fell by a dramatic 18.7 percent during the 10 months to December 2015. Textiles and garments, which contribute close to 50 percent of country's total exports, declined by 12.8 percent in December, the third consecutive monthly fall. Tea, the second largest export, fell by almost 25 percent in December compared to the same month in the previous year. Despite large falls in oil imports, the country's trade deficits for 2014 and 2015 were still over $8 billion.

Another blow to the economy has been declining workers' remittances, mainly from the Middle East. These fell by 0.5 percent to $6.9 billion in 2015, down from $7 billion the previous year.

On February 29, Fitch Ratings downgraded Sri Lanka from BB-, three levels below investment grade, to B+. The outlook was also shifted to "negative" at the lower level suggesting a possible further downgrade. Fitch gave several reasons for its decision, including increased refinancing risks on account of large upcoming debt repayments and declining investor willingness to buy local-currency government securities. Fitch estimated that Sri Lanka's current foreign exchange reserves are only sufficient to cover 2.9 months of external payments.

Finance Minister Karunanayake and Central Bank Governor Arjun Mahendran angrily dismissed the downgrade, declaring it was the opinion of just one institution. Moody's, which maintained Sri Lanka's B1 stable rating, said, however, that Colombo's attempts to secure loans from the IMF and the Asian Development Bank revealed "Sri Lanka's credit-negative vulnerability to external event risk."

Sri Lanka's downgraded rating and tax announcements saw a further slide on the Colombo stock market this week. Share prices fell by 2 percent on Wednesday, to the lowest level in 27 months.

Miflal Farook, a senior advisor to Asia Securities Stockbrokers, told the media the that "market is going down with latest tax reviews by the government, which indicates the economy is going to contract and will slow down the growth of major companies and put downward pressure on share prices."

Wickremesinghe's economic statement indicates that the economy is on a precipice and that the government is preparing even more ruthless attacks on jobs, wages and other social rights of the working class and the poor.