Sri Lanka government raises VAT following IMF demands

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26 September 2016

The Sri Lankan cabinet on September 13 approved a bill reintroducing an increase in the value added tax (VAT) it had previously withdrawn in response to widespread opposition. The bill will soon be presented to parliament.

The 4 percentage point increase in the tax—from 11 percent to 15 percent—will impact on numerous consumer items and services. It will severely affect the living standards of workers, the poor and sections of the lower middle class.

The cabinet decision followed a two-week International Monetary Fund (IMF) mission to Sri Lanka to review the progress of various pledges made to the bank by the government.

IMF team chief Jaewoo Lee told the media it "could not 'in good conscience' recommend the release of the second tranche to the Executive Board of the IMF in November" unless the government increased the VAT to 15 percent.

In June, the IMF approved a $US1.5 billion loan to Sri Lanka to avert a balance of payments and financial crisis. The loan was offered on the condition that the pro-US Sirisena-Wickremesinghe government sharply reduced the fiscal deficit, increased the VAT and carried out various "economic reforms," including the privatisation of state-owned enterprises.

The VAT increase, however, was temporarily withdrawn in August amid growing anger and protests by workers and small traders. A Supreme Court ruling in July, claiming there had been a procedural error in the gazette notification of the tax increase, was used by the government as a legal cover to withhold immediate implementation of a higher VAT.

Following the IMF review team's latest announcement, health minister and cabinet spokesman Rajitha Senaratne told the media that "the government couldn't wait till the new budget [in mid-November] to impose VAT [increases] because the country's finances [are] in dire straits."

In an attempt to pacify small traders, the bill contains some cosmetic changes, such as increasing the VAT threshold for retail traders from 15 million rupees ($US103,000) per annum to 50 million rupees. However, the VAT will now be imposed on essential services, such as health, telecommunications and basic food items, including milk powder, that were previously excluded.

The VAT on telecommunication services will be 50 percent and there will be sharp hikes in medical consultation fees and operations in private hospitals. VAT exemptions on low-cost housing projects are to be reduced and will now apply to residential accommodation projects worth less than $5 million.

In addition to the higher VAT charges, the government is increasing Special Commodity Levies (SCL) on essential food items. The levy on sugar, for example, has been raised by nearly 2 rupees per kilogram. A 75-rupee levy also will be imposed on the local sales of garments produced for export.

Finance Minister Ravi Karunanayake reassured the IMF team that the government aimed to reduce this year's budget deficit to 5.4 percent of gross domestic product (GDP), down from last year's 6.7 percent. He said the deficit would be cut to 4.7 percent next year and reach the IMF target of 3.5 percent by 2020.

The government is already in the process of selling the national carrier, Sri Lanka Air Lines, and several other state-owned enterprises such as the Hilton Hotel, Grand Hyatt and Lanka Hospitals. Electricity and water rates will also be increased in line with IMF demands that state funding be cut to these public sector entities.

Hit by the ongoing global recession, Sri Lanka's economic problems are deepening with declining exports and falling foreign investment.

* The trade deficit reached $4.2 billion in first half of this year, a 2.2 percent increase over the previous year, and is expected to reach $8.5 billion this year.

* During the first half of the year, foreign investment dropped to $4.5 billion, a staggering 52.5 percent decline on the previous year.

* Export earnings in the first half of this year declined by 5.8 percent compared to last year.

In a media comment on the vulnerability of the Sri Lankan economy, University of Colombo economist Sirimal Abeyratne noted that European Union countries, one of the country's largest markets, were still in recession. He warned: "The global economy will face tremendous economic pressure if the US Federal Reserve Bank hikes its interest rates. This would impact Sri Lanka because the cost of borrowings would considerably increase."

Desperately seeking foreign investment, the government is selling stakes in a range of public enterprises by listing them on the Colombo Stock Exchange (CSE). CSE chairman Vajira Kulatilaka told the Colombo media: "When the government divests part of its holdings in these entities through the CSE, these entities automatically become listed companies."

The country's balance of payments depends heavily on the remittances of Sri Lankan workers, mainly in the Middle East. *Sunday Times* economist Nimal Sandaratne recently commented: "Without these remittances the external finances of the country would be in a pathetic state."

Middle Eastern countries, in fact, account for around 60 percent of the remittances—$3.6 billion in first half of this year and equivalent to more than 70 percent of Sri Lanka's export earnings. The rate of increase in remittances, however, declined to 5.6 percent this year, down from 10 percent in previous years.

Volatile oil prices, the escalating war in Syria and the protracted crises in Libya and Iraq are taking a heavy toll on poor countries dependent on foreign remittances from the Middle East.

The new VAT and other tax increases, on top of the already declining living conditions, are setting the stage for an eruption of mass struggles by the working class and the poor.

For months there has not been a single day without demonstrations or protests by workers, farmers or students demanding salary increases or opposing subsidy cuts to essential items, privatisation of state-owned enterprises and the slashing of public education.