

IPS's SOE'17 and Tax Policy in Sri Lanka

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There is an unintended coincidence

- Irrationality economist Richard Thaler gets Nobel Prize for economics in 2017
- IPS publishes its State of the Economy 2017 with focus on 'Demographics, Labour Market and Growth'
- Message: Sri Lanka's thrust toward prosperity depends on how it could 'de-skill and re-skill' its 'irrational stock of labour'

Vision 2025 of the government

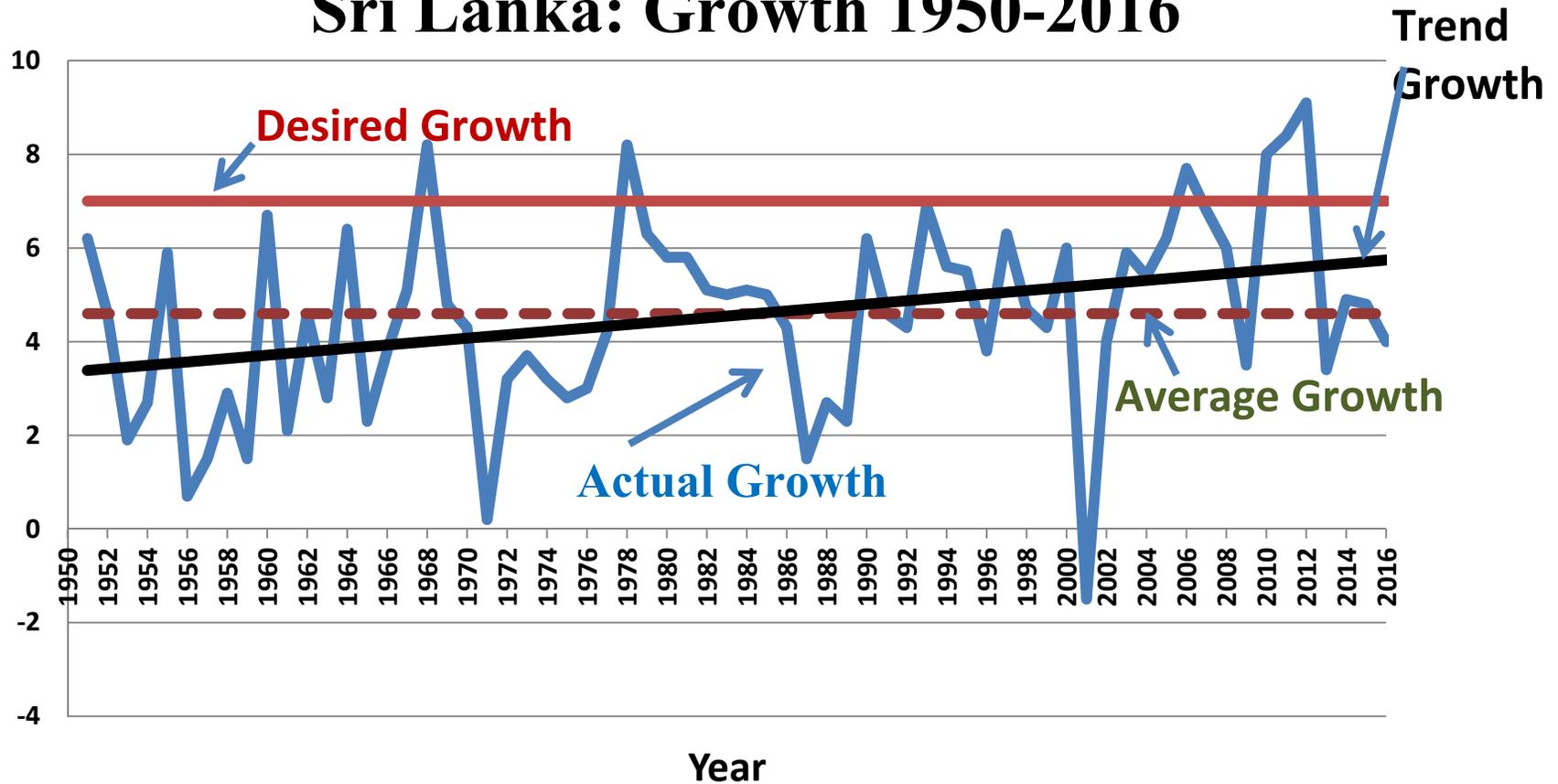
- Focuses on ‘high technology and human knowledge’ plus ‘competitive markets’ as contributors to prosperity
- SOE runs through the current state of the human capital stock and proposes a ‘policy capsule’ for adoption by the government
- The conflict: SOE’s prescriptions are medium to long term while government’s desire is to win the next two elections
- The prescription: While focusing on the long term, manage short term costs with quick fixes

Economic Challenge

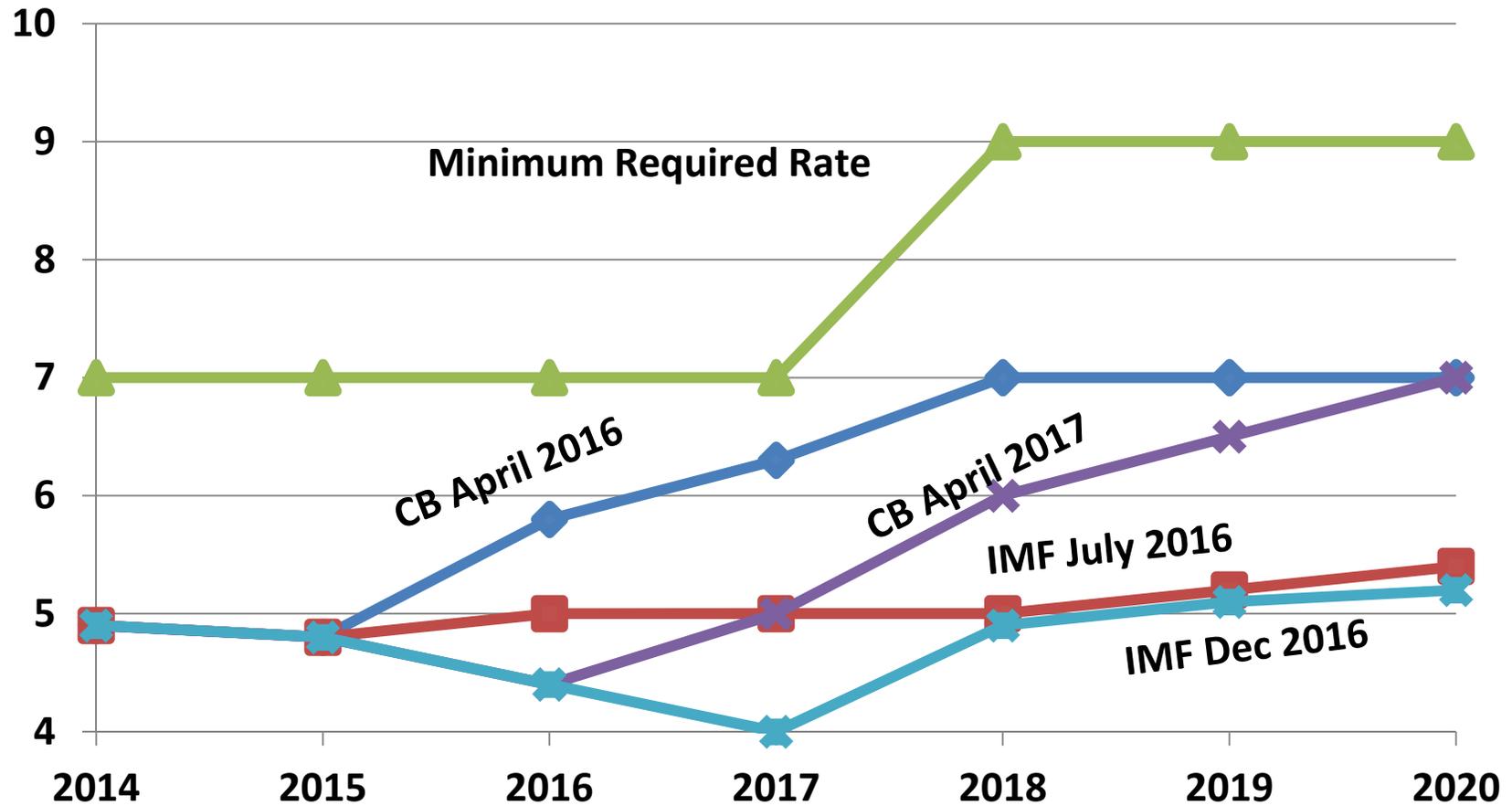
- 2017 is a write-off and what is lost in the current year has to be recovered with faster growth in the next 8 to 30 years
- The use of all the options for speeding up the growth in the next 8 year period
- Laying foundation for a solid investment base, augment domestic savings, consolidate the budget and ease the debt problem

Historical Scorecard

Sri Lanka: Growth 1950-2016



Sri Lanka: Medium Term Growth Projections



Immediate term measures

- Focus on promoting the export of both 'goods and services' to generate higher income
- Export of goods is constrained by structural problems and loss of competitiveness
- Structural problems arise from 'skills deficits', 'regulatory bottlenecks', 'inefficient public services', 'failure to harness technology'
- Competitiveness has been lost due to high wages, difficulty in doing business, high start-up costs and corruption at all levels

Export of services

- Presently an untapped and unfocused market, but has immense potential for the future
- A alternative for a natural resource-poor country
- Vision 2025 focuses on developing Sri Lanka as an Indian Ocean Hub and developing the Colombo Port City Financial Centre
- SOE's prescription: Develop technical education and vocational training, quality assurance in private higher learning institutions, easing doing business and creating a creative capital

Ingredients of the Policy Capsule

- The long term policy prescription by IPS for the government
- If interested on sustained long term growth, should not ignore
- Focuses on reforming the labour market, improving the skill base of the labour force, reforming education, improving the technology base

Labour market reforms

- Firms can hire but cannot fire
- Sri Lanka has the highest termination package
- Employers follow methods to circumvent the law and the casualty is the employment creation
- IPS has proposed to ease the burden on employers while helping workers through a 'flex security' system

Improvement of skill base

- Increase access to quality higher education
- Introduce accreditation systems to assure quality in private sector higher learning institutions
- Concentrate on math, science, vocation based education system
- Change school and university curricula to produce needed skills

Have a better plan for labour migration

- Shortage of labour and presence of illegal workers in Sri Lanka
- Incentivise migrants to return and re-integrate them to work force
- Attract global talents to cross fertilise local talents
- Match migration with domestic labour requirements

Policy prescriptions for

- Harnessing tourism potential for the country
- Reforming the land market to release land for needy economic enterprises
- Introducing better disaster risk management schemes
- Linking Sri Lanka's growth to UN's sustainable development goals
- Assuring food security
- Tackling non communicable diseases
- Mainstreaming shadow education (tuition)
- Ageing and healthcare for all
- Eliminating child poverty
- Protecting trade related intellectual property rights (TRIPs)

Overall

- SOE has identified main constraint for Sri Lanka's long term development: lack of innovative human capital
- Policy prescription is for the long term and the government concentrating on short term election cycle should not ignore it
- Should have a programme to harmonise sound economics and political expedience

Tax Policies in Sri Lanka

A collection of 9 papers covering

- How taxation will support macroeconomic stability and growth?
- How to improve tax revenue?
- How taxation could be used to enhance production base?
- How to tackle issues like lack of equity and low elasticity in taxation?

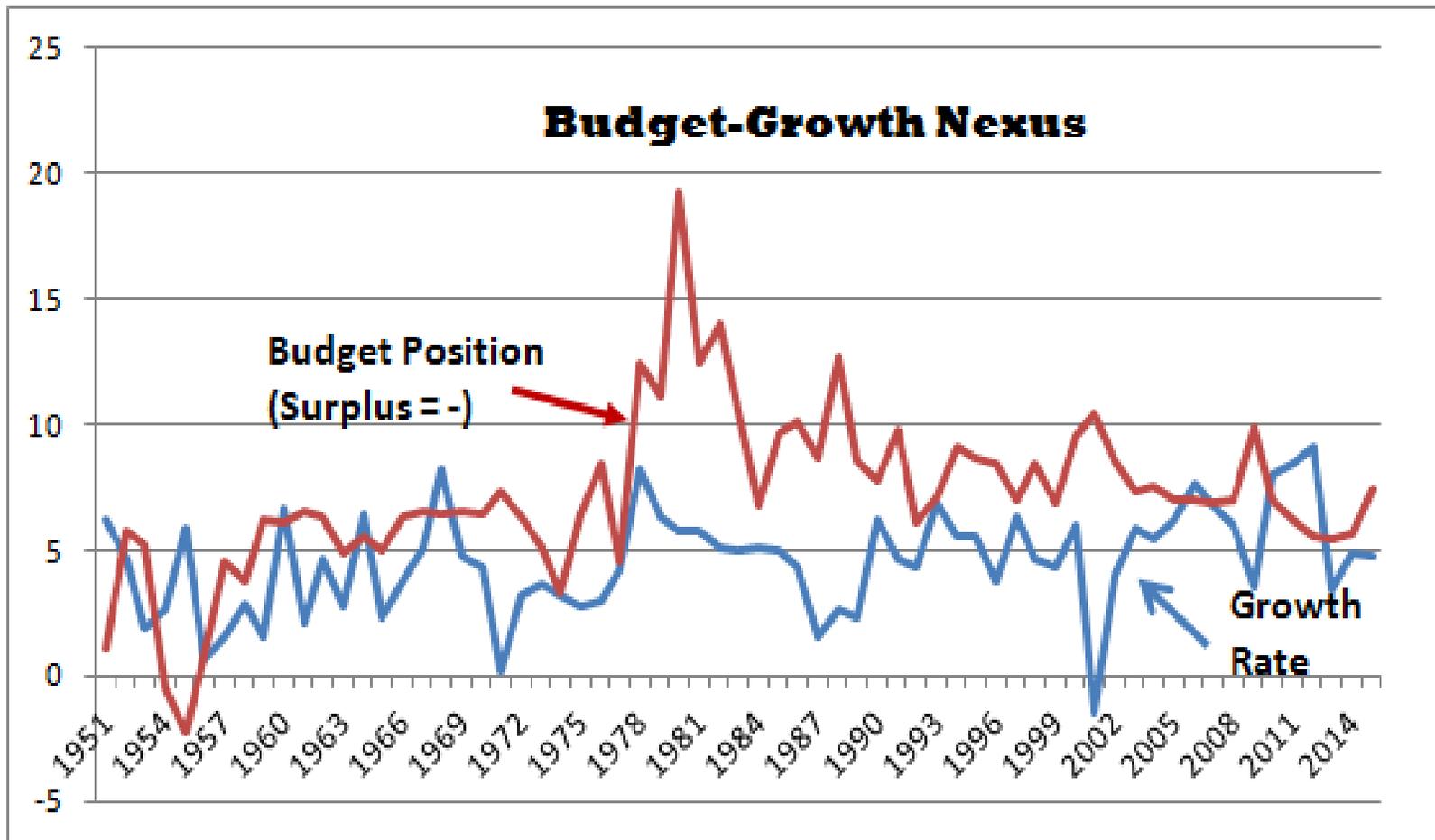
Introduction by Saman Kelegama has highlighted

- The economic policy during 2005-14 was based on generating growth via debt financed consumption and investment
- It created the problem of external debt overhang
- To overcome the problem and direct the economy toward sustained long term growth tax revenue has to be augmented
- The current volume proposes ways and means of reforming tax system to attain a higher tax revenue

Dushni Weerakoon and Kithmina Hewage

- Talks on how fiscal policy contributes to growth and macroeconomic stability
- Growth has basically come from private consumption (75-80%) and not from public expenditure during 2011-15
- Uncontrolled government expenditure has brought in undesirable growth of public debt, pressure for inflation and currency depreciation and low growth
- Recommendation: Consolidate budget, improve macro stability and create conditions for growth

Has government funding contributed to growth?



Three papers by D D M Waidyasekera, Kopalapillai Amirthalingam and Mick Moore

- Talk on the present state of declining tax revenue in proportion to income growth
- With historical data, they have concluded that the current tax level is not the optimal and should be increased
- This is a point which the government policy makers, researchers and international agencies agree on
- Writers have drawn on the need for changing the composition of the tax structure from indirect to direct and the government too has accepted it as its medium term goal
- The challenge is how it could be sold to the public who have to pay more taxes to run the ballooning public services year after year

Two papers by Anushka Wijesinha with Jayani Ratnayake and Raveen Ekanayake

- Talk how taxes could be used to augment the production base through FDIs and SMEs
- FDIs, the saviour of Sri Lanka today, have been given a mixture of complicated tax incentives with poor results as demonstrated by actual receipts
- Anushka and Jayani argue that the best is a low tax regime for all the industries and FDIs should be given targeted tax incentives.
- But the removal should be done cautiously over a period
- Today, the general acceptance is that FDIs come not due to tax incentives but due to the presence of other business friendly factors in the economy

Taxes and SMEs

- Policy makers have favoured SMEs due to their widespread presence in the economy and their potential to evolve into large enterprises
- But does tax incentives help them? Anushka and Raveen through a survey have found that 93% of them do not pay taxes due to their low income
- They have a general fear of entering the tax system due to its complicated nature
- If SMEs are to be incentivised, tax concessions should be given to large enterprises that outsource inputs/parts from them and place them in the global supply chain

Nisha Arunatilake and Priyanka Jayawardena

- Evaluate tax reforms from a social equity point
- Use a model to estimate tax incidence across households and impact on tax revenue and welfare of people
- Using three tax reforms in 2007 and 2011, a mixed result has been drawn for tax income with high tax incidence falling on high earning households
- Though all reforms have a progressive element, if the tax rates are reduced, its impact on reducing the revenue is more.

Finally, paper by Yuthika Indraratna

- Assess the tax elasticity in Sri Lanka
- Using data for 1960 to 1994, she finds that Sri Lanka's tax elasticity is less than 1 meaning that growth in income does not generate an equal increase in tax revenue
- The main culprits are tax exemptions, duty waivers, tax incentives, low compliance and non-taxing vibrant sectors
- All these are policy determined factors and will serve for policy guidance in the future
- It would be interesting if data for 1995-2016 are also tested to see whether they also show the same pattern

Overall

- The volume is a good attempt and it adds to knowledge and helps policy making
- Dr Saman Kelegama should be posthumously congratulated for the effort taken to bring this out
- IPS should build a communication line with the government to make its findings and wisdom known to key policy makers

The End

