

# Import Controls in Sri Lanka: Political Preference and Incentive Distortions

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Posted on July 12, 2023 | Shipping and Transport, Trade

Battling an unprecedented economic crisis that overlapped the COVID-19 pandemic, Sri Lanka resorted to strict import controls since early 2020. These measures gradually encompassed 31% of total imports by September 2022, with the intention of reducing foreign exchange leakages on "non-essential" imports. However, the effectiveness and implications of these stringent regulations have raised questions. A new publication by the Institute of Policy Studies of Sri Lanka (IPS) delve into the effects of these controls on the country's trade policy and economic landscape.

The study titled "Import Controls in Sri Lanka: Political Preference and Incentive Distortions" by IPS researchers, Dr Asanka Wijesinghe, Chathurrdhika Yogaraja, and Nilupulee Rathnayake examines the preferences of policymakers in implementing import controls and their potential impact on domestic production and electoral considerations.

Through a quantitative analysis using a unique dataset constructed by the authors, the study explores the distortions in the incentive structure that promote import substitution. It considers factors such as the impact of products on foreign reserve positions, their importance to domestic production, domestic substitutability, and interest group pressure. The study identifies eight waves of import controls during the study period spanning from April 2020 to September 2022. The findings reveal that by the end of 2022, import controls were primarily imposed on food imports, consumer items, and electronics. This structure of import controls creates an environment conducive to import substitution, reversing the gains from structural transformation. Moreover, the study highlights the potential ramifications for the country's nutritional security as the continuous



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imposition of import controls on food products may have severe consequences.

The study recommends a gradual phase-out of import controls, starting with intermediate and essential nutritious food items. It emphasises the importance of removing import controls on consumer goods, including food, to encourage resource allocation towards export-oriented industries and alleviate domestic price inflation. The removal of import controls on consumer goods will also mitigate the burden on low-income urban and suburban households, safeguarding their nutritional security.

The research underscores the need for the government of Sri Lanka to prioritise the removal of import restrictions on consumer goods and focus on expanding the growth of the export sector. By doing so, the country can address the balance of payment crisis, foster innovation, and enable participation in global value chains.

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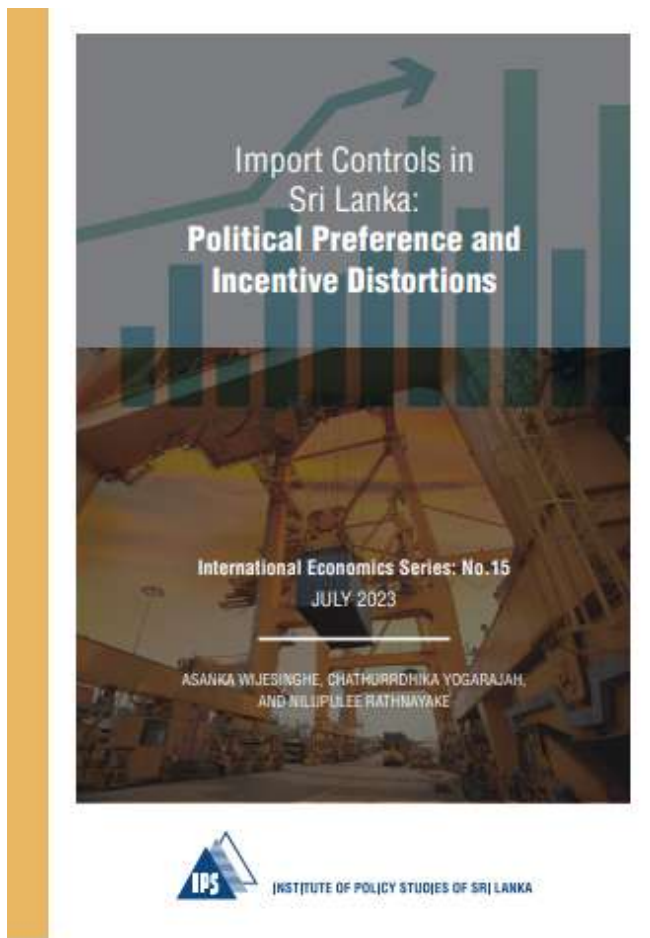
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