

An Analysis of the Effects of Special Commodity Levy on Food Inflation in Sri Lanka

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INTRODUCTION AND RESEARCH PROBLEM

Having first show signs of an increasing trend in late 2006, world food prices increased with remarkable rapidity in 2007 and 2008, posing serious concerns across the world. By June 2008, the Global Food Price Index computed by the Food and Agricultural Organization reached a peak of 214 index points, recording an increase of 44 per cent year-on-year. This surge of food prices combined with high petroleum prices threatened social stability in some developed and almost all developing nations, where poorer households having a larger share of foods in their total budget suffered the most due to the increasing cost of food.

High food prices have had an adverse impact on Sri Lanka since the country continues to import a significant quantity of its food requirements every year. Out of Sri Lanka's total consumer goods imports, food imports accounted to 43, 47 and 53 percent in 2006, 2007 and 2008 respectively, suggesting that high food prices in the world market could have a significant effect on domestic food inflation. Food accounts for a significant share of the total consumer expenditure, and to provide relief to consumers, the government of Sri Lanka dealt with high food prices on many fronts. One measure

adopted was the reduction of the duties applicable to essential food items through a composite tax in 2008.

Until 2008, Sri Lanka had a very complex food import policy regime characterised by multiple taxes, year-to-year variations, and lack of uniformity across food commodities. The total tax calculation performed by the Department of Customs uses a composite formula which enables the government to charge taxes on taxes. The multiple taxes charged in 2008 included Customs Duty (CD), Port and Airport Development Levy (PAL), Value Added Tax (VAT), Commodity Export Subsidy Scheme (CESS), Social Responsibility Levy (SRL), Surcharge and Regional Infrastructure Development Levy (RIDL).

As stated earlier, the government introduced a single composite levy known as Special Commodity Levy (SCL) in 2008 instead of CD and other applicable taxes at the point of importation. The SCLs were initially applied on eleven essential food items, i.e., sugar, potatoes, dhal, peas, chickpeas, big onion, green gram, sprats, dried chillies, canned fish and milk powder. Later on more products were added into the SCL list, which now contains more than 32 products.

The above phenomenon can be considered as a movement towards uniformity in tariffs. In recent years, many developing countries have moved away from non-tariff barriers and highly complicated tariff structures to a few tariff rates that do not discriminate heavily across sectors. Policy economists, frustrated by the complexities of trade policy regimes in most developing countries, find the replacement of all trade restrictions by a single uniform tariff as the most effective instrument in minimizing trade policy distortions, while academic economists working in the tradition of optimal tariff and tax literature rarely think of a uniform tariff as a serious policy option (Panagariya, 1990 and 1996). A justification for a uniform tariff given by policy economists is transparency and administrative simplicity, avoidance of misclassification of goods for evasion of tariffs and ease of minimizing distortions (Panagariya, 1996).

In light of the above background, the general objective of the study is to examine the extent to which SCL influences the cost of a food basket. The specific objectives are:

- (i) To compute the difference between the initial rates of tariffs as introduced in the beginning of the year and the SCL rate
- (ii) To compare the cost of food basket with the SCL and without the SCL

METHODOLOGY OF ANALYSIS AND DATA

Out of more than 32 SCL levied food items, 9 were selected for analysis. Each item accounts for more than 1% of total food expenditure of the consumer food basket according to the 2009/2010 and 2012/2013 Household Income and Expenditure Survey (HIES) of the Department of Census and Statistics (DCS). The selected food items were potatoes, big onion, sugar, dried sprats, coconut oil, dhal, chilli powder, milk powder and red onions. The SCL was introduced to potato, chilli, big onion, sugar, dried sprats, milk powder and dhal in 2008, red onions in 2009 and coconut oil in 2012. They were subjected to many revisions within the year that followed.

Initial rates of tariffs for selected food items as introduced in the beginning of each year during the 2008- 2014 period were taken from the Custom Tariff Guides published annually by the Department of Customs. CIF prices of the selected commodities were extracted from the Central Bank Annual Reports and the Trade Map data base. The average monthly expenditure per person on the above items were extracted from the 2009/10 and 2012/13 HIESs and the SCLs applied on those food items were extracted from the Gazette notifications and Sri Lanka Customs. Colombo Consumer Price Indices for 2008-2014 were extracted from Central Bank Annual Reports.

The formula used by Sri Lanka Customs was used to estimate the initial total tax values for each year for each selected food item. After considering the effective time period of initial tariff rate and the effective time period of SCL, the total tax values after imposition of SCL for each and every food item was calculated. The difference between the initially announced total tax value and value after the imposition of SCL was measured for the nine food items.

Average monthly expenditure per person for each selected commodity in 2008 and 2014 were computed using the CCPI and the HIES survey data for 2009/10 and 2012/13. Considering this estimated average monthly expenditure per person for a particular food item as the expenditure in the presence of SCL, the average monthly expenditure without SCL was calculated using the percentage difference between the initially announced total tax value and the total tax value after the imposition of SCL.

RESULTS AND FINDINGS

Food Consumption Pattern of Sri Lanka

According to the 2012/13 HIES, the estimated average monthly household expenditure was Rs.41, 444 and among the major categories of household consumption expenditure, the estimated average monthly expenditure on food was Rs.15, 651. According to the 2009/10 and 2012/13 HIES, average monthly expenditure per person on food and drink was Rs. 3, 481.07 and Rs. 4, 031.97 respectively. The statistics show a clear rise in average monthly household expenditure as well as the average monthly expenditure on food from 2009/10 to 2012/13.

According to 2012/13 HIES, the highest percentage of household expenditure from total expenditure on food and drink was spent on rice (13.6%), followed by fish (9.1%), condiments (9%), milk and milk products (8.9%) and vegetables (8.2%). In the same year, the

highest expenditure was recorded on consumption of cereals followed by prepared food, other food items, fish, condiments, milk and milk food, vegetables, coconuts, meat, dried fish, pulses, sugar jaggery and treacle, fruits, and fats and oils respectively. Rice is the highest consumed food item per month followed by sugar, bread and fish.

Initial Tax Rates versus SCL

Table 1 shows the average initial tax rate, average SCL rate and the difference between them during the period of 2008-2014. The highest % change reported as 32.45% for potatoes followed by Red onion (27.18%), chilli (26.065) and milk powder (24.22%).

Table 1: Percentage Change between Average Initial Tax and Average SCL (2008-2014)

Commodity	Average Initial Tax %	Average SCL %	% Change
Potato	99.49	67.04	32.45
Sugar	38.79	25.12	13.66
Dhal	20.51	10.45	10.05
B-onions	83.49	62.70	20.78
Dried sprats	25.01	11.57	13.43
Chilli	57.40	31.33	26.06
Red onion	64.94	37.76	27.18
Coconut oil	55.52	53.41	02.11
Milk powder	26.32	02.09	24.22

Each year, the total tax value after the imposition of SCL has been lower than the initial value for potato, chilli, dried sprats, red onions and milk powder. In some occasions the opposite also was observed: i.e. for sugar in 2008 and 2014, dhal in 2012, coconut oil in 2014 and big onions in 2012, SCL value exceeded initial total tax value.

Table 2: Initial Tax and the Tax after the Imposition of SCL (Rs/kg): 2008-2014

Year	Potato			Chilli			Sugar			Dhal-Whole			Dried Sprats			Coconut Oil			B'Onions			Red Onions			Milk Powder		
	Initial Tax	Tax wt	SCL	Initial Tax	Tax wt	SCL	Initial Tax	Tax wt	SCL	Initial Tax	Tax wt	SCL	Initial Tax	Tax wt	SCL	Initial Tax	Tax wt	SCL	Initial Tax	Tax wt	SCL	Initial Tax	Tax wt	SCL	Initial Tax	Tax wt	SCL
2008	21.00	16.59		57.00	30.59		14.00	14.30		13.00	04.20		21.00	20.85		50.00			24.00	20.09		15.00			86.00	35.22	
2009	39.00	22.44		69.00	45.51		24.00	14.42		26.00	10.32		44.00	28.32		52.00			29.00	22.40		18.00	16.88		100.85	84.98	
2010	30.00	12.68		43.00	25.00		22.00	04.77		26.00	04.55		46.00	30.00		59.00			32.00	13.33		30.00	15.88		142.00		
2011	37.00	26.36		92.00	27.01		30.00	05.00		19.00	10.00		46.00	30.00	110.00				30.00	15.92		37.00	25.00		170.00		
2012	35.00	30.16		122.00	55.93		30.00	15.16		16.00	17.74		59.00	20.66		66.00	55.17		28.00	34.88		28.00	24.41		178.00		
2013	27.00	23.34		271.00	150.00		28.00	23.25		25.00	18.00		77.00	11.80		129.00	110.00		35.00	20.86		26.00	13.77		186.00		
2014	43.00	23.33		222.00	150.00		27.00	29.53		22.00	07.10		52.00	26.00		84.00	110.00		31.00	20.66		19.00	05.00		210.00		

Expenditure with and without SCL

According to results indicated in table 3, the monthly expenditure per person on consumption of potatoes, dhal, chilli powder, red onions and dried sprats has reduced significantly due to the imposition of SCL during the period 2008-2014. After the introduction of SCL on milk powder the total monthly expenditure per person on milk powder shows large reductions, particularly in 2009 and 2010.

In most cases, the monthly expenditure per person on particular food items was reduced after the imposition of SCL but the opposite was also observed for big onion in 2012 and coconut oil in 2014 and sugar in 2008 and 2014.

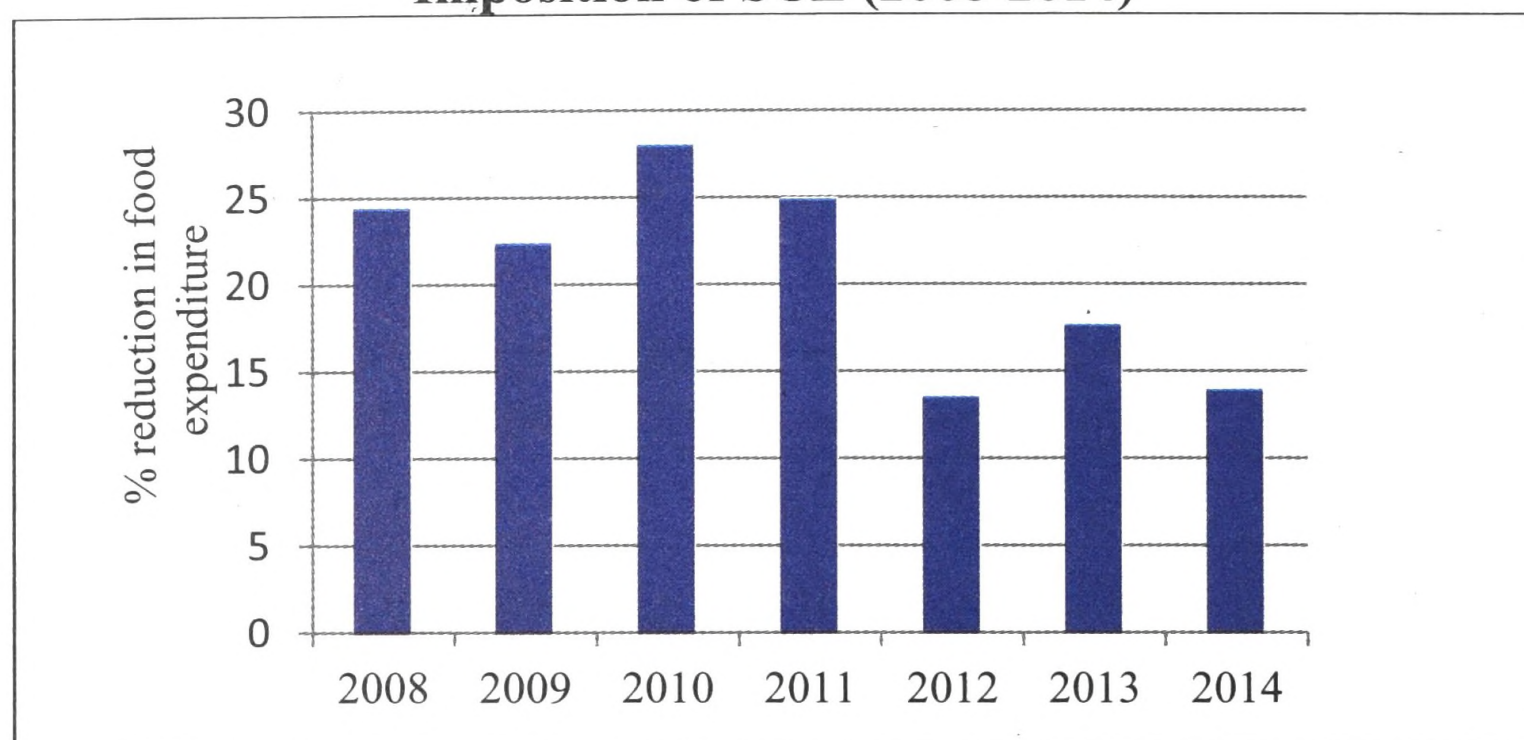
Table 3: Percentage Change in Monthly Expenditure/Person due to the Imposition of SCL (2008-2014)

Commodity	2008	2009	2010	2011	2012	2013	2014
Potato	17.36	29.80	36.60	22.34	12.15	11.94	31.38
Sugar	02.19	28.53	43.92	45.45	33.10	14.50	10.34
Dhal	40.37	38.19	45.40	32.14	12.21	21.88	40.38
B-onions	14.01	18.54	36.84	31.94	32.57	28.77	25.01
Dried sprats	00.70	26.28	25.81	25.81	39.39	45.85	33.33
Chilli	31.66	25.40	29.51	41.40	35.13	30.87	24.49
Red onion	0.00	05.95	32.01	24.49	11.36	31.99	42.42
Coconut oil	0.00	0.00	0.00	0.00	14.10	12.84	44.82
Milk powder	38.16	13.60	0.00	0.00	0.00	0.00	0.00

Reduction in Total Food Expenditure due to SCL

The results indicate that due to the imposition of SCL, the total monthly expenditure per person on consumption of selected 9 food items was reduced by Rs.213.26, Rs.197.11, Rs.265.33, Rs.254.05, Rs.127.45, Rs.174.49 and Rs.155.46 in the years spanning 2008 to 2014, respectively.

Figure 1: Percentage Reduction in Food Expenditure due to Imposition of SCL (2008-2014)



Assuming the cost of all the other food items remained the same, the reduction in total food expenditure due to the SCL was 5.66%, 7.62%, 3.16% and 4.33% in 2009, 2010, 2012 and 2013, respectively.

CONCLUSION

In conclusion, through the introduction of a single composite levy on specified commodity items in lieu of all other import taxes, the government has succeeded in reducing consumer expenditure on food and in simplifying the tax system by reducing the number of taxes and the non-uniformity of taxes across commodities. This shows that the government is attempting to move towards a uniform tariff structure which in turn will improve the transparency and administrative simplicity.

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