

**Sathya
Karunarathne**
Author

**Aneetha
Warusavitarana**
Author

INNOVATION



FREEDOM



PROSPERITY

International Trade Barrier Index 2021

Protectionist Tariffs Compromising Sri Lanka's Middle-Income Earners' Right to Shelter

Case Study

Abstract

Sri Lanka's Urban Development Authority (UDA) states that over fifty percent of Colombo's (the island's capital) population lives in underserved settlements and a total of 68,812 families living in 1,499 community clusters have no access to basic infrastructure facilities such as clean water, electricity, sanitation, etc. A part of Sri Lanka's housing problem is attributed to the extortionate tariffs on essential construction goods and materials. These sky-high tax regimes accentuate the discriminatory inefficiencies that exist within Sri Lanka's housing sector, which compromises the average Sri Lankan's ability to construct their own house.

The average domestic consumer is placed in a position of difficulty, while the domestic producer benefits vastly from the regressive tax regime in place. The exorbitant prices of imported construction goods and materials contribute toward creating a captive market, thereby allowing domestic producers to snowball their prices to the point where they enjoy supernormal profits. The price-taking consumer is now faced with a dilemma of choosing between costly imported raw materials and inflated local goods.

Protectionist Tariffs Compromising Sri Lanka's Middle-Income Earners' Right to Shelter

By Sathya Karunarathne¹ & Aneetha Warusavitarana²

TBI 2021

ADVOCATA

1. Fellow

2. Research Analyst

I. A Global Overview of Housing

The Housing Needs Assessment and Data Survey of 2016 outlines that out of six million families living in Sri Lanka only 5.2 million have some form of housing. Housing scarcity is not endemic to Sri Lanka and extends across countries, proving the crisis knows no geographical boundaries. Housing systems all over the world are increasingly prone to volatility placing the sustenance, welfare, safety and right to shelter of middle and low-income earners at an increased risk.

UN-Habitat estimates that by 2030, three billion people or about 40 percent of the world's population will need access to adequate housing with 100 million homeless worldwide; and one in four million people living in harmful conditions to their health, safety and prosperity.

II. Sri Lanka's Housing Affordability Crisis

Sri Lanka's Urban Development Authority (UDA) states that over fifty percent of Colombo's (the island's capital) population lives in underserved settlements and a total of 68,812 families living in 1,499 community clusters have no access to basic infrastructure facilities such as clean water, electricity, sanitation, etc. A part of Sri Lanka's housing problem is attributed to the extortionate tariffs on essential construction goods and materials. These sky-high tax regimes accentuate the discriminatory inefficiencies that exist within Sri Lanka's housing sector, which compromises the average Sri Lankan's ability to construct their own house. The average domestic consumer is placed in a position of difficulty, while the domestic producer benefits vastly from the regressive tax regime in place. The exorbitant prices of imported construction goods and materials contribute toward creating a captive market, thereby allowing domestic producers to snowball their prices to the point where they enjoy supernormal profits. The price-taking consumer is now faced with a dilemma of choosing between costly imported raw materials and inflated local goods.

Given the extenuating circumstances of the coronavirus pandemic and the fiscal pressures that the government had to face, the importation of certain materials used in the construction of houses was suspended. While these import restrictions were placed with the intention of relaxing the strain on the island's balance of payments, they created a significant cost burden on the average Sri Lankan. Domestic producers were given the liberty of pricing these goods without the restraint created by competition. Amidst hope that this burden placed on the Sri Lankan consumer may be temporary, the 2021 budget solidified protectionist measures by only allowing the importation of raw materials that cannot be produced domestically, further hampering competition in the market. In other words, the average consumer will continue to bear the brunt of these distortionary policy measures.

Looking at the basic construction materials utilized in the construction of a typical house in Sri Lanka,¹ the average tariff levied across multiple HS codes can range from 11% to as high as 203.7%. Table 1.1 illustrates the average tariff rate for each type of material, which highlights that average tariffs for different types of material can go as high as 95.2%.

Usage	Material	HS Code of the Median	Tariff Rate Pre-2021 Budget	Tariff Rate Post-2021 Budget
Wall	Bricks	6902.10.90	52%	53.6%
Roof	Asbestos	6811.40.20	93.6%	95.2%
	Tiles	6905.10.00	52%	71.4%
Floor	Cement	2523.21.00	29.1%	33.1%
	Ceramic	6904.90.00	52%	53.6%
	Tiles	6802.91.10	19.6%	19.6%
	Steel	7216.40.00	35.8%	30.4%
Bathrooms	Sanitary Ware	7324.29.00	63.9%	65.5%

The result of these high tariffs is that the final cost of goods is drastically increased, an issue that has been highlighted by the Construction Industry Development Authority (CIDA) in their report on the way forward for the construction industry post COVID-19.² Stakeholder surveys conducted by CIDA reiterate the problem of high costs of materials. The report identifies that the suspension of imported materials into the country has created shortages, driving prices up in the domestic market. The CIDA estimates that the industry sources approximately 60% of construction material requirement comes from local sources.³

1. Profile of Urban and Rural Population in Sri Lanka: Alternative Estimates, Institute of Policy Studies, Bilesha Weeraratne, <https://www.ips.lk/profile-urban-rural-population-sri-lanka-alternative-estimates/>

2. http://www.cida.gov.lk/sub_pgs/wayForward.html

3. Ministry of Urban Development, Water Supply and Housing Facilities, Construction Industry Development Authority, Development of Sri Lanka's Construction Industry: the Way Forward After COVID-19, June 2020.

III. Lessons from the U.S.A.

In March 2018, the Trump Administration imposed anti-dumping tariffs on aluminum and steel with a stiff tariff of 25 percent on steel and 10 percent on aluminum on every foreign shipment. Moreover, in late January 2020, it was decided to further extend these tariffs to cover a wide range of products made with these metals.

Similar to the case in Sri Lanka, the underlying intentions of these tariffs were placed in the good faith of expanding local industries, to help level the playing field in the market for local steel and aluminum producers, and increasing job opportunities; however, the outcomes of these protectionist policies have failed to reflect its initial intentions.

A U.S.-based think tank has expressed their concerns over the protectionist measures and have stated that the imposed tariffs are estimated to reduce long-term GDP by 0.23 percent, wages by 0.15 percent, and employment by 179,800 full-time equivalent jobs. Moreover, the Administration's decision to impose additional tariffs would, if acted upon, further reduce GDP by 0.24 percent, wages by 0.17 percent, and employment by 184,200 full-time equivalent jobs.⁴

IV. Opportunities for Reform

The 2021 Budget has standardized the General Duty and PAL across almost all HS codes that fall under imported construction material. This reform is very much welcome as the General Duty which previously stood at 30% has now been reduced to 15%. However, the para tariff CESS has been increased to 50% where it was previously 35%, and a CESS of 15% has been introduced on HS codes where it was previously not applicable.

The proposed reform recommendation is that the para tariffs, CESS and PAL, are brought down to 0%.

Refer to table 1.2 for the tax break down;

4. Tracking the Economic Impact of U.S. Tariffs and Retaliatory Actions, Erica York, September 18th, 2020, <https://taxfoundation.org/tariffs-trump-trade-war/>

	Tax Component					
Material (HS Code)	General Duty	VAT	PAL	CESS	Total Nominal Tariff (as a % of the value of the good)	Recommended Reform: Removal of para tariffs CESS and PAL and bringing the tax rate to between 8.8% and 25%
Bricks (6902.10.90)	15%	8%	10%	15%	53.62%	25%
Asbestos (6811.40.20)	15%	8%	10%	50%	95.2%	25%
Tiles (6905.10.00)	15%	8%	10%	30%	71.4%	25%
Cement (2523.21.00)		8%	10%	2 per kg	33.1%	8.80%
Ceramic (6904.90.00)	15%	8%	10%	15%	53.62%	25%
Tiles (6802.91.10)		8%	10%		19.60%	8.80%
Steel (7216.40.00)	10%	8%	10%		30.4%	19.6%
Sanitary (7324.29.00)	15%	8%	10%	25%	65.5%	25%

Please note that the above table is arrived at on a median breakdown basis, or in other terms, selecting the type of material with a median cost value under each major construction material category.

Introducing reduced tariffs on imported construction material carries the potential to increase competitiveness in the local market, provide incentives to local producers to increase the quality of construction material, ensure affordability, and facilitate the housing needs of middle and low-income earners. While these extortionary taxes affect the ability of middle-income earners to build their own houses, it is no secret that it also affects start-up costs of businesses, especially construction incentive sectors such as hotels and apartments. Therefore, reduced costs on construction material would increase the island's ease of doing business, attracting more investments along with much needed foreign direct investments.



THOLOS
FOUNDATION

TRADEBARRIERINDEX.ORG