Sri Lankan president announces major tax concessions for foreign investors

By W.A. Sunil
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Sri Lankan President Gotabhaya Rajapakse has announced large tax concessions for international investors following his government's reactivation of the Strategic Development Projects Act (SDPA) of 2008.

Last week's decision, which had been put on hold for three years by the Sirisena-Wickremesinghe government, was taken after the cabinet approved a paper presented by Rajapakse. The government is desperate to boost foreign direct investments (FDI).

Under the SDPA, tax exemptions are granted for up to 25 years for "identified strategic development projects." Other concessions for foreign investors include the non-payment of the value added tax (VAT) and the removal of various legal barriers related to obtaining land and infrastructure facilities.

The SDPA was first initiated by the President Mahinda Rajapakse's government in February 2008 amid the escalating war against separatist Liberation Tigers of Tamil Elam. It was revised twice in 2011 and 2013 to broaden its concessions.

The paper approved by cabinet last week blamed the Sirisena-Wickremesinghe government's restrictions on the SDPA for "hampering international investor sentiment," along with what it claimed was the adverse impact of Sri Lanka's complex tax system.

While there was widespread criticism of long-term tax cuts and easy access to land for foreign investors, the Sirisena-Wickremesinghe government was not opposed to the SDPA concessions. It granted tax holidays for foreign investors until they made profits from their projects and promised other more comprehensive concessions to foreign capital.

The deeply-divided government was unable to implement its promised concessions and began to fall apart after Sirisena distanced himself from Prime Minister Wickremesinghe and then attempted to remove him and his government in the face of workers' strikes and protests against International Monetary Fund-dictated austerity measures.

Gotabhaya Rajapakse, backed by his Sri Lanka Podujana Peramuna, came to power by exploiting the widespread popular hostility and making populist promises to reduce the price of essentials and improve social conditions. The past two months, however, have exposed the Rajapakse government as a ruthless tool of big business and international capital.

Rajapakse's cabinet paper boasted that the new government has taken various measures to improve "business confidence."

On Monday, the big-business *Daily FT* claimed that the Business Confidence index had recorded an increase of 75 percent basis points in December. It commented: "The tax reforms, reduction of VAT to 8 percent from 15 percent, and lowering of the government expenditure as well as other changes, seem to have endeared the government, both business and consumers."

While VAT has been reduced, there has been no fall in the price of essentials, with big business gaining the full benefit of the tax cut. In December, the official inflation rate climbed to 6.2 percent, with food prices rising 4 percent.

The *Daily FT* editorial hailed Rajapakse's reactivation of the SDPA as a "positive" step, declaring that Sri Lanka "is in dire need of more investment and exports to drive growth and put the economy on a better footing."

The newspaper declared that "wider reforms are also crucial to this process." In other words, the restructuring and privatisation of state enterprises must be intensified, jobs destroyed and working conditions slashed to provide even cheaper labour for investors to exploit.

The IMF has long insisted on these "reforms" in line with its demand for Sri Lanka to reduce it fiscal deficit to 3.5 percent of the gross domestic product (GDP). Last year the fiscal deficit rose to 7 percent of GDP. The Rajapakse government, which confronts rising debt levels and declining export income, has said that it will hold discussions with the IMF and attempt to reduce its fiscal debt to 4 percent of GDP this year.

According to Central Bank reports, Sri Lanka has to pay $6 billion on external loans over the next 12 months. Early this month Central Bank Governor W.D. Lakshman warned the government that the country was "at a crossroad" with "many challenges" to overcome.

"As far as financial flows are concerned, Sri Lanka continued to experience low levels of foreign direct investment [FDI]. Outflows from the market for rupee denominated government securities and the stock market continued, albeit at a much slower pace than in the previous year," Lakshman said.

Sri Lanka has been unable to reach an expected $3 billion in annual FDI over the past three years. Inflows, in fact, were only around $1 billion a year.

The outflow of rupee-denominated government securities is a direct impact of international fluctuations. The prime investors in Sri Lankan government securities are from the US, but they are withdrawing funds and shifting investments to more lucrative markets.

Desperate to attract international capital, so-called less developed countries are offering even cheaper labor and more attractive concessions. The Rajapakse government's latest tax announcements are an attempt to undercut its economic rivals and stop the foreign capital outflow from Sri Lanka.

On Monday, Prime Minister Mahinda Rajapakse met with Colombo stockbrokers, assuring them that he would boost the local stock market and give "priority" to "attracting investment."

The brokers want larger amounts from pension funds, such as the Employees Provident Fund and the Employees Trust Fund, released onto the stock market. They claim pension fund exposure to listed equities markets in East Asian countries is between 17 and 40 percent whereas in Sri Lanka it is only 5 percent. Brokers also want selected state-owned enterprises, or part of them, listed on the stock market to "boost liquidity and market capitalisation."

The new prime minister, who is expected to face a general election in April and is anxious to prevent mass opposition by workers and the poor, did not immediately agree to the brokers' demands.

Rajapakse has declared that he needs a two-thirds majority to establish strong government and impose the class war measures being demanded by global finance and the corporate elite. This means massive attacks on the living and social conditions of workers and the poor and will provoke the eruption of strikes and protests, in line with the unfolding international working-class upsurge.