“Sugar Scam” is not the whole iceberg: “Forestalling” needs a rule-of-law solution

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On 14 October 2020, taxes on imported sugar were slashed overnight from LKR 50 to LKR 25 cents per kilogram. That is a reduction of 99.5%. This led to much discussion in media and parliament about the large undue profits that accrued to those who had been primed in advance to keep large stocks ready to clear from customs soon after this reduction. This policy was reversed last week, but raised the exact same concerns in the opposite direction.

The point of this article is not only to highlight these problem in economic governance but to suggest practical action that can contain not just the “sugar scam”, but the entire class of such problems that are draining government revenue in Sri Lanka. **This problem has a name. It is called “forestalling”, and it can be tamed: by legislation and regulations.**

What is the “Sugar Scam”?

The public discussion on the revenue lost in changing sugar taxes has been so widespread and constant that it has spawned into common parlance in Sri Lanka a new phrase: “sugar scam”. The meaning it conjures up is that of a corrupt act, where the Minister of Finance (ab)used his power to change the tax overnight, with connected interests poised to make a very large profit from that sudden decision.

The market prices of sugar didn’t decline as might have been expected. Instead, the gap between the landed imported price and market price increased to capture the lion’s share of that tax reduction. This meant that the action not only led to super profits for the primed importers — it also continued to translate in the next few years into windfall increases in producer surplus (difference between imported cost and market price) rather than consumer surplus (reduction in market price).

Impervious to corrective change

In the case of sugar, these huge losses to government revenue — to the tune of about LKR 2 billion a month, was sustained for 37 months. All the way through the financial crisis, and all the way through increases in consumption taxes and income taxes on the population at large. Even the desperate situation that Sri Lanka was in, needing to recover government revenue that had fallen to record low levels, did not result in a change in this tax.

The analytical wisdom of increasing this tax at least back to LKR 50 was well known. First, the auditor general published a report showing the country lost LKR 16 billion in revenue in the 5 months up to February 2021 due to this tax reduction. Then, Verité research published its analysis in March 2023 on publicfinance.lk (https://bit.ly/Revenue_Loss_Sugar_Scam), analytically updating the auditor general’s calculation and setting out the recommendation for an immediate increase in this tax back to its previous level.

Nevertheless, the government remained stoic and impervious to the opportunity to collect desperately needed revenue, as well as the injustice of how economic rents were being redistributed from the many, to the few. Since the gazette notices on this tax are valid only for a particular period of time, the government re-issued the notices keeping the special commodity levy (SCL) at 25 cents in January, April, and October of 2021, as well as in January and June of 2022, and again in January 2023.

Sugar Scam 2.0 with tax adjustment

The Civil Society Governance Diagnostic Report (GDR) and the IMF's Technical Assistance Report Governance Diagnostic Assessment (GDA) – both published in September 2023 – highlighted the importance of rectifying what happened with Sugar Scam 1.0. Finally, the tax was refixed at LKR 50 on 2 November 2023.

That is, all the hullabaloo in society and all the revenue analysis did not make any difference until the International Monetary Fund (IMF) stepped in and issued a red notice, while suspending the release of the second tranche in the current programme.

Following this revision, the media has been agog with news about Sugar Scam 2.0. Once again it is thought that vested interests benefited, now in the opposite direction — having paid the low tax and cleared large quantities of imports just before the tax was increased.

Even though we don't have data for what happened in the days and months prior to the latest revision, the data does suggest that stockpiling extra supplies, in anticipation of a tax increase, had been taking place within the year.

In 2023, average monthly sugar imports by end July (latest available data) was 61% more than the average monthly sugar imports in 2022. If that increase was due to stockpiling (given that the economy as a whole was still contracting), at that rate there could be as much as 5-6 months' quantity of excess sugar imports stocked up by the end of October.

"Sugar Scam" is a class of anti-market behaviour

While it is the "sugar scam" that was found out, there will be numerous other such occurrences that remain unknown until the data is examined. This class of anti-market behaviour is what is referred to as "forestalling".

Available data already points to forestalling occurring with regard to increases in cigarette production and taxes. This has been highlighted in reports done by Verité Research as well as the World Bank. To quote the 2017 World Bank report titled 'Sri Lanka: Overview of Tobacco Use, Tobacco Control Legislation, and Taxation'

> "Forestalling was another factor of revenue decline in early 2017. In anticipation of tax increases, manufacturers may take advantage of the current or lower tax and increase production or stock of products (known as forestalling). The President of Sri Lanka announced plans on substantial tax increases for cigarettes on June 1, 2016. Ceylon Tobacco Company had 4 months to increase cigarette production and taxable wholesales..."

The report goes on to provide analytical quantified evidence of forestalling in Sri Lanka's production and taxation of cigarettes.

Forestalling with regard to cigarettes came into further public attention when a media article on Newshub.lk titled "BOC approves loan worth Rs. 2,150 million to stockpile cigarettes ahead of budget" reported that a government bank provided a loan of over LKR 2 billion to a cigarette resale agent to specifically enable forestalling. The article ()described how forestalling was done in broad-daylight, and perhaps without even a sense that it was a wrongful act. All the research and material related to this incident is now available at:

From Naming the behaviour to taming the behaviour

The term 'forestalling' has been used and recognised as an offence in English law from at least as far back as 1321,when there were rules formulated against it.

The problem in Sri Lanka is not simply that such behaviour is routine, but that it is not named and recognised as being an anti-social practice that should be legally restricted.

Sri Lanka ratified the Framework Convention on Tobacco Control (FCTC) in 2003. The FCTC recommends that each country "Impose effective anti-forestalling measures, in anticipation of tax increases". Verité Research in its report done for the National Authority on Tobacco and Alcohol (NATA) titled "FCTC Evaluation Sri Lanka's compliance with Article 6", available at https://bit.ly/40q6YlP, stated as follows:

> "The current legislation does not provide any specific measures to prevent forestalling. While government authorities do collect monthly data regarding cigarette production that allows for an assessment of the degree of forestalling, they do not raise concerns of forestalling. As such, there are no legislative provisions or measures against forestalling in place."

Sri Lanka has so much discretion provided to the executive arm to easily amend different types of taxes, that the problem of forestalling has a much wider application than cigarette taxes.

Currently, legal action may be possible against forestalling because it might fit the definition of corruption: where decision making power is abused to benefit private interests at the cost of the public interest. fundamental rights applications invoking the violation of public trust might also be possible. But an explicit law against forestalling is absent.

It might be possible to start by promulgating regulations under existing laws governing market behaviour – to recognize forestalling as an anti-market practice and tax evasion (e.g. the Consumer Affairs Authority Act, No.9 of 2003, Excise Ordinance Act, and Excise Special Provisions Act No. 13 of 1989).

Sri Lanka can then proceed to borrow from laws passed internationally, which allow the government to take actions to prevent, as well as punish, forestalling behaviour. This is a recommendation in relation to tobacco written in the Civil Society GDR as well – suggesting that Sri Lankan society is also waking up to the need to name and tame forestalling with a rule-of-law solution.

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