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Rationalising Sri Lanka's Tariff Regime: CID Reform and CESS Phase-Out

1. Introduction

The Government has introduced a comprehensive reform of Sri Lanka's import tariff regime through the implementation of a simplified four-band Customs Import Duty (CID) structure, aligned with the UN Broad Economic Categories (BEC Rev.5)[1], alongside a phased removal of para-tariffs, particularly the CESS. This reform forms a key component of the 2026 fiscal and trade policy agenda, aimed at improving export competitiveness, strengthening the investment climate, and transitioning toward a more transparent and rules-based tariff system.

At its core, the reform reflects a bifurcated economic strategy. On one hand, it prioritises the reduction of tariffs on capital and intermediate goods to lower the cost of production and support domestic value addition. On the other, it introduces a more structured and, in some cases, higher tariff regime on consumption and luxury goods to manage import demand while safeguarding government revenue. Importantly, the reform maintains policy stability by preserving existing duty-free categories and fixed (specific) duties, thereby avoiding disruption to critical sectors.

Group A: Industrial Support		
1	Capital Goods	0%-10%
2	Intermediate Goods	0%-10%
Group B: Market Management		
3	Consumption Goods	20%-30%
4	Luxury Goods	30% (Upper Cap)

Table 01: Version 5 methodology

To illustrate the structural shift introduced by the reform, the distribution of tariff lines across rate bands shows a clear movement toward consolidation and simplification, particularly through the elimination of the 15% band and the introduction of a 10% and 30% band.

[1] https://unstats.un.org/unsd/trade/classifications/Manual%20of%20the%20Fifth%20Revision%20of%20the%20BEC%20(Unedited).pdf

Category	Current No HS	Current %	Proposed Number HS	Proposed %
Free	3725	45.6%	3742	45.5%
10% Rate (New)			455	5.5%
15% Rate	526	6.4%	Eliminated	
20% Rate	2660	32.5%	2165	26.3%
30% Rate (New)			594	7.2%
Mix – Rate	413	5.1%	416	5.1%
Fix – Rate	852	10.4%	853	10.4%
Total	8176	100%	8225	100%

Table 02: Comparative Structure: Current Vs Proposed Distribution

2. The 4-Band CID Structure: Simplification with Strategic Intent

The proposed four-band CID structure represents a deliberate shift away from a fragmented and often complex tariff system toward a more streamlined and predictable framework. By consolidating tariff rates into clearly defined bands 0% to 10% for capital and intermediate goods, and 20% to 30% for consumption and luxury goods the reform reduces ambiguity in classification and enhances administrative efficiency. The elimination of the 15% tariff band is particularly significant, as it removes an intermediate layer that previously contributed to inconsistencies and discretionary interpretation.

This restructuring is not merely administrative but strategic. Lower tariff bands for industrial inputs are intended to facilitate production and integration into global value chains, while higher bands for final consumption goods function as a tool for demand management and revenue mobilisation. The approach therefore balances competing policy objectives growth and fiscal stability within a simplified tariff architecture.

Category (BEC Rev.5)	HS Lines	CID Treatment/ Description
Consumption Goods	610	CID 20 % to 30% Incl. rationalization of mixed rates
Consumption Goods	106	CID 15 % to 20% Incl. rationalization of mixed rates
Intermediate & Capital Goods	480	CID 15% to 10% Incl. rationalization of mixed rates
Intermediate Goods	1	CID Free to 10% Incl. rationalization of NTP decision
Intermediate Goods	2	CID 20 % to 10% Incl. rationalization of NTP decision
Intermediate Goods	22	CID unchanged with uniform rate application
Intermediate & Capital Goods	1174	Existing CID rates maintained on a transitional basis
Intermediate, Capital and Consumption Goods	5830	CID rates unchanged to preserve exemption, ensure supply, revenue certainty & public health objectives
Total/Net Impact	8225	

Table 03: The proposed 4-Band CID Tariff structure

3. Implications for Production and Industrial Competitiveness

One of the most immediate and tangible impacts of the reform is the reduction in tariffs on key industrial inputs, particularly the shift from 15% to 10% on a range of intermediate goods. This adjustment affects a wide spectrum of sectors, including agro-processing, chemicals, textiles, construction materials, and machinery etc. Inputs such as wheat grain, animal feed, inorganic chemicals, woven fabrics, iron and steel

products, and industrial equipment will become relatively less costly to import, directly reducing production expenses for domestic firms.

From an economic perspective, this reduction in input costs has several important implications. Lower production costs can enhance the competitiveness of domestic industries, particularly export-oriented sectors that operate within tight international price margins. It also creates incentives for firms to move up the value chain by engaging in processing and manufacturing activities rather than relying on primary production. However, the extent of these benefits will depend on how effectively cost savings are transmitted through the production process and whether firms respond by expanding output, improving quality, or investing in productivity enhancements.

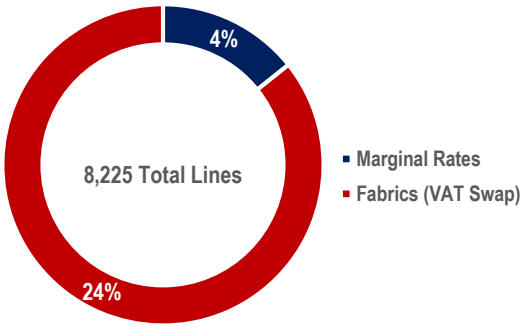
4. Effects on Consumption and Import Dynamics

In parallel with support for production, the reform introduces targeted adjustments to tariffs on consumption goods, with many items shifting into the 20% to 30% range. These include a mix of food products, household goods, and consumer durables such as processed foods, dairy items, washing machines, carpets, and vehicles. The intention behind these adjustments is to moderate import demand, particularly for non-essential goods, while maintaining a stable revenue base.

This aspect of the reform reflects a classic trade policy trade-off. While higher tariffs on consumption goods can reduce import volumes and support domestic producers, they can also lead to higher retail prices and increased cost of living pressures. Moreover, sustained protection may reduce competitive pressures on local industries, potentially affecting efficiency and innovation over time. As such, the demand management objective must be carefully balanced against broader welfare and competitiveness considerations.

5. A Calibrated Approach to Reform

The CID reform follows a calibrated approach. Rather than introducing sweeping changes across the entire tariff schedule, the reform targets specific areas while maintaining overall stability. Approximately 88% of HS codes remain unchanged, with only 12% subject to revisions. This suggests a deliberate effort to minimise disruption while addressing key inefficiencies within the system.



The Stability Metric

7,225 HS Codes remain unchanged, 1,000 HS codes are subject to rate changes

Technical Adjustments

76 new HS sub-divisions created

27 HS sub-divisions deleted

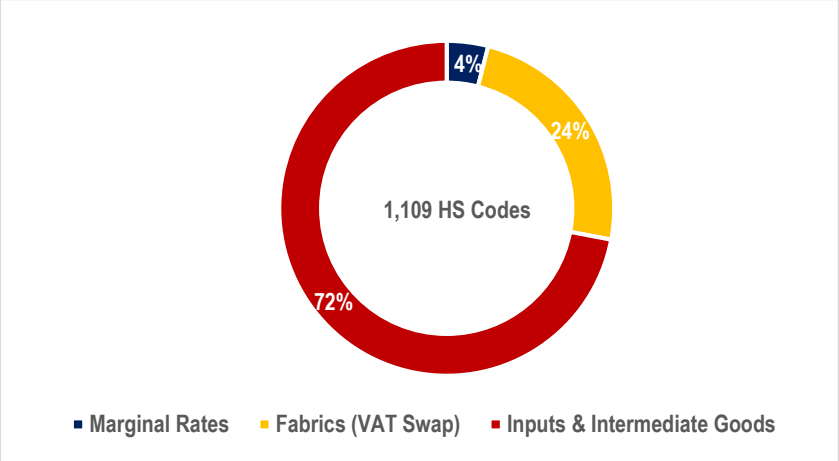
6 HS codes underwent description amendments

Figure 01: Structural Overview-Targeted reform

In addition to tariff adjustments, the reform includes technical refinements such as the introduction of new HS sub-divisions, the removal of redundant and minor amendments to product descriptions. These changes, although administrative in nature, are important for improving clarity, reducing misclassification, and enhancing the overall functionality of the tariff regime. Taken together, the approach reflects a balance between reform ambition and implementation pragmatism.

6. CESS Phase-Out: Toward a Transparent Tariff Regime

Complementing the CID restructuring is the phased removal of the CESS, a para-tariff that has historically contributed to the complexity and opacity of Sri Lanka's trade regime. The current phase of the reform targets 1,109 HS lines, is structured across three categories based on the extent of tariff reduction and sectoral focus.



Category 01: 46 HS Codes

Category 02: 798 HS Codes

Category 03: 265 HS Codes

Figure 02: Phase 02 Composition: Breakdown of the 1,109 HS Codes

The first category consists of 46 HS codes, representing approximately 4% of the total, where CESS is fully removed. This segment primarily addresses residual or marginal tariff lines that no longer align with current policy priorities. Products included in this category range from raw cocoa beans and industrial fatty acids to plastic packing materials and specialised packaging components such as collapsible tubes. The removal of CESS in these cases contributes to simplification of the tariff schedule and elimination of low-impact levies.

The second category, which constitutes the largest share at 798 HS codes or approximately 72%, involves a 50% reduction in CESS. This segment is focused on reducing input costs across a broad range of productive sectors. It includes fisheries-related inputs such as fish meal and processed crustacean products, agricultural goods such as paddy and king coconut, and food processing inputs including unroasted coffee beans, soya bean flour, and flour derived from dried leguminous vegetables. Industrial inputs such as coconut oil, wool grease, and related fatty substances are also included. The scope of this category indicates an emphasis on supporting value-added activities across agriculture, manufacturing, and processing industries.

1	VAT 0%	Applied to 258 tariff lines (TL)
2	VAT 18%	Applied to 7 Tariff Lines (TL)

Table 04: Category 03 – The Textile Strategy and VAT Integration

The third category (See Table) comprises 265 HS codes, or approximately 24% of the total, and is concentrated on textile inputs, particularly fabrics. In this segment, CESS is fully removed, with implementation linked to April 1, 2026. This measure is accompanied by the introduction of Value Added Tax (VAT) on imported fabrics. Under this framework, VAT at 0% applies to 258 tariff lines, while a standard rate of 18% applies to 7 tariff lines. The combination of CESS removal and VAT application is intended to maintain neutrality between domestic production and imports while reducing input costs for export-oriented industries.

7. Economic Implications and Implementation Challenges

The combined effect of CID rationalisation and CESS removal is expected to be broadly positive for the economy, particularly in terms of reducing production costs, improving export competitiveness, and enhancing investor confidence. A simpler and more transparent tariff regime can also reduce compliance costs and improve the ease of doing business.

However, the reform is not without challenges. The removal of para-tariffs may lead to short-term revenue implications, requiring corresponding adjustments within the domestic tax framework to maintain fiscal balance. In addition, industries that previously operated under higher levels of tariff protection may face increased exposure to import competition, necessitating a period of transition and adaptation. Historically, para-tariffs such as CESS have played a role in protecting domestic industries and generating revenue, and their removal alters both cost structures and competitive dynamics.

Implementation dynamics are also a key consideration. While the CESS phase-out was initially expected to be implemented from April 1, 2026, subsequent developments indicate a more staggered and phased approach rather than an immediate full removal. Official statements confirm that the reform began with a 50% reduction in CESS rates from April 2026, with further reductions scheduled over multiple years rather than a single-step elimination. In addition, the implementation timeline has been extended for certain sensitive sectors, with a group of 107 HS codes across several industries scheduled to begin reductions only from 2027, reflecting concerns around exposure to import competition and domestic industry adjustment[2]

At the same time, selected categories have proceeded as initially planned. For example, textile-related inputs have seen full removal of CESS from April 1, 2026, accompanied by the introduction of VAT on imported fabrics, indicating that implementation has been differentiated across sectors.

The staggered approach reflects an attempt to balance competing policy objectives, including reducing production costs, maintaining fiscal stability, and managing adjustment pressures in domestic industries. However, variations in implementation timelines and sequencing may affect business planning and investment decisions if not clearly communicated. The effectiveness of the reform will therefore depend not only on its design, but also on the consistency, transparency, and predictability of its execution, as well as alignment with complementary measures such as domestic taxation and trade facilitation.

[2] https://www.ft.lk/top-story/Trade-reforms-slow-as-Govt-phases-cess-rollback/26-790209

8. Conclusion and Policy Direction

The introduction of the four-band CID structure and the phased removal of CESS represent a significant step toward modernising Sri Lanka's trade policy framework. By aligning tariffs with economic function and reducing reliance on para-tariffs, the reform moves the country closer to a system that supports production, encourages exports, and improves transparency.

Nevertheless, the success of these reforms will depend critically on consistent implementation and the presence of complementary policies. Strengthening domestic tax systems, improving trade facilitation, and supporting industry adjustment will be essential to fully realise the benefits of tariff rationalisation. If effectively managed, this reform has the potential to enhance Sri Lanka's integration into global value chains and support a more sustainable, export-oriented growth.

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