Sri Lanka

Macroeconomic and policy context

Key statistics	
GDP growth (annual) (2007-2017)	5.6%
GDP growth (annual, per capita) (2007-2017)	4.8%
CO_2 emissions growth (annual) (2007-2017)	2.4%
CO_2 emissions growth (annual, per capita) (2007-2017)	1.6%
Main combustible energy source; corresponding share of CO2 emissions (2017)	Biofuels, 48.1%
Non-combustible energy sources; share of primary energy use (2017)	3.2%
Total energy self-sufficiency (%) (2017)	42.0%
Share of population with access to electricity (2018) SDG 7.1.1	100.0%
Share of population with access to clean cooking (2018) SDG 7.1.2	31.0%
Tax-to-GDP ratio (2017)	27.3%

Sources as specified in TEU-SD brochure.

Between 2007 and 2017, Sri Lanka's GDP grew by an average of 5.6% per year in total, and 4.8% per capita. Over the same period, energy-related CO_2 emissions increased by 2.4% per year in total, and 1.6% per capita. Biofuels accounted for 48.1% of CO_2 emissions from energy use in 2017, down from 62.5% in 2007. Diesel, the main fossil fuel used, accounted for 16.5% in 2017. Non-combustible energy sources, mainly hydropower, accounted for 3.2% of primary energy use in 2017, down from 3.6% in 2007. Sri Lanka is a net energy and oil importer with a complete electrification rate but only 31.0% of the population having access to clean cooking.

The government of Sri Lanka has committed to pursuing sustainable economic development policies focused on addressing Sri Lanka's vulnerability to climate change and expanding domestic renewable energy production in its First Nationally Determined Contribution. In this NDC, Sri Lanka set a GHG emissions reduction target for the energy sector of 4% unconditionally and 16% conditionally by 2030, relative to the BAU scenario. Sri Lanka's tax-to-GDP ratio of 27.3% is lower than the OECD average[1] of 33.9%, but higher than the LAC and Africa averages of 22.8% and 17.2%, respectively.

Taxes and subsidies on energy use, 2018

Sri Lanka does not have an explicit carbon tax, nor a CO_2 emissions trading system. However, it does collect energy taxes, including:

♦ Excise duties on gasoline and diesel.

TEU-SD classified two subsidies to be in effect in 2018:

♦ The supply of fuel below cost-recovery levels, affecting various petroleum products and sectors including fuels used as input for electricity generation.

♦ The supply of electricity at prices below cost-recovery levels.

Net energy tax revenues, 2018

Net energy tax revenues are a bottom-up estimate of the net revenues resulting from taxes and subsidies on energy use.

Net energy tax revenues in Sri Lanka are negative, in the magnitude of 0.3% of GDP in 2018, contributing negatively to domestic resource mobilisation as subsidies exceed taxes. Compared to the other countries considered in TEU-SD and OECD countries:
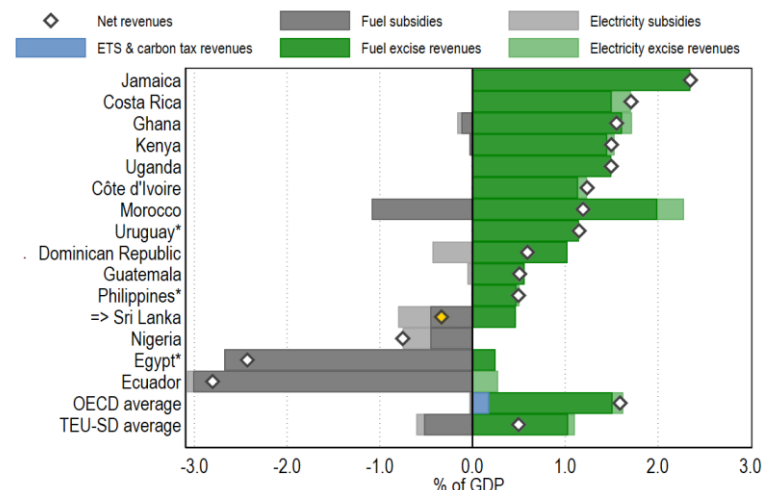
* Since 2018, Egypt has phased out most subsidies on energy use and the Philippines have implemented a major tax reform. In Uruguay, certain fuels like diesel attract VAT but not an excise.

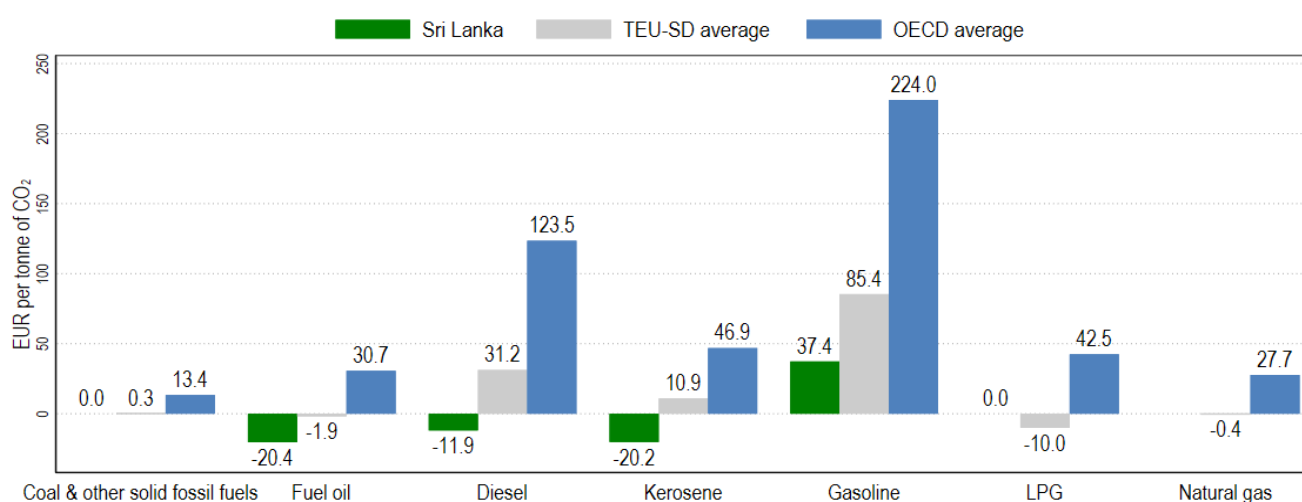[1] Averages across countries refer to the simple, unweighted average.

- Revenues from fuel and electricity excise taxes as a share of GDP are lower than the OECD and TEU-SD averages.

- Subsidies for fuel and electricity are higher than the OECD and TEU-SD averages.

Recent developments: The IMF has advocated for energy pricing reforms in funding negotiations with Sri Lanka. In 2018, an automatic fuel pricing mechanism was approved by the cabinet, while a similar electricity pricing mechanism has been awaiting approval since 2018. These reform attempts have been suspended due to political resistance.

Average effective carbon rates by fuel, 2018

The Effective Carbon Rate (ECR) is the total price that applies to CO_2 emissions from energy use as a result of taxes and emissions trading, net of fuel subsidies. A higher ECR encourages consumers and producers to use cleaner energy sources or reduce energy use, avoiding CO_2 emissions and local pollution, while taxes and permit auctioning raise revenue.

- Gasoline, mainly used in road transport, faces the highest ECR, and the only positive ECR in Sri Lanka. The road sector is responsible for 23.7% of Sri Lanka's CO_2 emissions from energy use.

- Coal and LPG, mainly used in the electricity and residential & commercial sectors, face no ECRs. The former sectors represent 22.6% and 31.3% of Sri Lanka's CO_2 emissions from energy use, respectively.
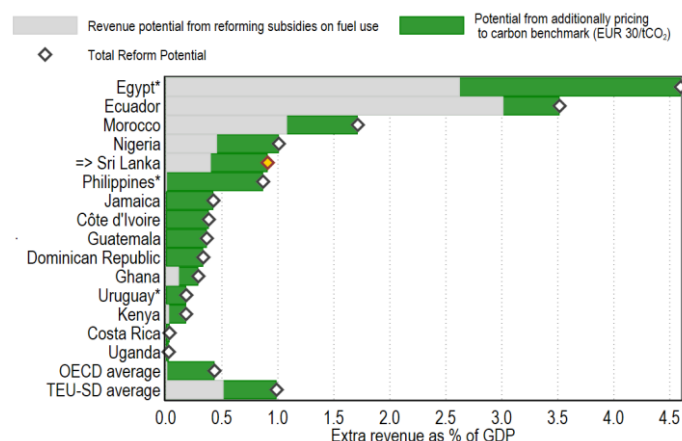
- Diesel, fuel oil and kerosene face negative ECRs.

Sri Lanka has low effective carbon rates relative to the OECD average. Compared to other TEU-SD countries:

- The ECR is low for diesel, fuel oil, gasoline and kerosene relative to the TEU-SD average.

- The ECR on coal is similar to the TEU-SD average.

- The ECR on LPG is higher than the TEU-SD average.

Revenue potential from carbon price reform

By how much would tax revenues increase if ECRs were raised to reach EUR 30/tCO$_2$ for all fossil fuels? The benchmark of EUR 30 is a low-end estimate of the climate damage caused by each tonne of CO_2 emitted. An equitable reform package is critical to ensuring that vulnerable groups, which also tend to be those that are disproportionately affected by climate change, will be able to access clean energy.

Sri Lanka's tax revenue potential from carbon price reform, if ECRs were raised to the benchmark rate of EUR 30/tCO$_2$, amounts to 0.5% of GDP. This is higher than the OECD and TEU-SD averages. Sri Lanka could also benefit from an estimated revenue increase corresponding to 0.4% of GDP by reforming subsidies on fuel use. Thus, Sri Lanka's total tax revenue potential from a carbon price reform is an increase of revenue in the magnitude of 0.9% of GDP.