



# DUTY FREE SHOPPING

The policy of import substitution, introduced in the early 1960's and enforced more rigidly in the early 1970's was found to have failed in many respects by the time the new government assumed power in 1977. A fundamental cause for failure of this policy is seen in the fact that Sri Lanka is geographically a small country, with a narrow spread of indigenous raw materials and therefore the type of development where most of the manufactured goods required are produced locally was not a practicable goal.

If the country was to advance economically, beyond a subsistence level, it was felt that Sri Lanka had to move aggressively into the fields of imports and exports. The first budget of the government in November 1977, emphasised that in order to revive the economy the output from the agricultural, industrial and trade sectors must be increased; and with a view to achieving this objective it was decided to abolish import controls and liberalise trade and exchange payments. The motive behind these 'decontrol' measures was to shift emphasis in the

economy towards a greater reliance on "market forces", and enable the country's production structure to gain the most from its comparative advantage. An essential facet of this 'open' economic policy was industrialization with an export bias, together with the concept of free trade, free ports and export processing zones. Duty free trading was naturally an essential part of this programme.

The concept of 'Duty Free Shopping' or Tax Free Trade was not unknown to Sri Lanka before the existing Duty Free Shopping Complex in Colombo was opened in October 1981. There were earlier attempts at Duty Free Trading such as the Airport shop at Katunayake, started in 1972 by the Orient Co. (Ceylon) Ltd., (subsidiary of the state owned BCC Ltd.), and later one at Chatham Street, Fort, operated by the Ceylon Hotels Corporation. The latter dealt in goods sold not fully duty free, but at a 25 percent rate of duty; while the airport shop was entirely duty free. Both were intended to attract tourists, transit passengers and other visiting foreigners and nationals visiting Sri Lanka on holiday.

The guiding principle behind duty free shopping is that international travellers are justified in purchasing goods without the added burden of import duties, that go into the buying price of consumer goods within countries. Import duties are levied for two basic reasons, firstly they are widely accepted as one way of raising revenue for the government and secondly they serve to protect industries in the home country.

The extent to which duties are applied to imports depends on the respective government's policies towards free trade. There is no uniformity in the enforcement of duties on imports. One country levies little or no duties

on its imports whilst another would operate a comparatively high and a wide range of import duties. The well known example of no import duty countries are Singapore and Hongkong, while many of the developing countries in this region, such as India, Pakistan and Bangladesh have wide ranging duty rates.

The bulk of international Duty Free Shopping does not take place in the country, but at its port of entry, unlike Colombo which has a 'downtown' duty free complex like the duty free shops in Hongkong or Singapore. Generally duty free shopping is permitted where the normal trade laws of a country are not applicable, such as at airports, in aircrafts, on ships and at country boundaries and the Duty Free Trade is very big business worldwide. It is estimated to have amounted to more than US\$ 5 billion in 1984.

The history of Duty Free Trade in Sri Lanka goes back to the colonial times where it was restricted to trade in ship stores only. In this trade Sri Lanka was not able to derive much benefit, as most of the ships belonged to foreign companies which were stocked in the Singapore or Hongkong harbours. After granting of Dominion Status the demand for duty free goods increased marginally with the increasing establishment of High Commissions and Embassies in the country. However, the increase was not remarkable for the first 10 years of our post-independent era as most of the embassies were accredited to Sri Lanka from India.

In the late fifties and early sixties when the Socialist bloc countries opened embassies in Sri Lanka, the country's duty free trade received a further boost. The ship stores duty free trade was revived once when the Suez Canal was closed in 1956; since vessels had to come round a long way via the Cape they had to be stocked up in Colombo.

Another phase in the growth of duty free trade came after the inauguration of the U.N. Technical Assistance Programme in Colombo in the early 1960's. A large number of UN personnel began to come in as experts and since they were entitled to duty free privileges duty free trading in Sri Lanka received a further impetus.

The next important stage in the history of Duty Free Trade began with the establishment of the Colombo International Airport in 1967 and the opening of a duty free concessionaire for liquor and tobacco at Katunayake. Since then the development of duty free trade in Sri Lanka aimed at international standards till ultimately a 'downtown' complex was opened in Colombo in 1981.

An significant factor influencing the growth of Sri Lanka's duty free trade is the proximity of India. India has adopted both quantitative and qualitative measures to restrict imported goods, as part, of her overall economic strategy. These restrictions have been in force for over thirty years. Although every conceivable product is manufactured in India, there still exists a thriving appetite for imported goods among Indians and this urge was to prove a major incentive in the initial stages of the Duty Free Shopping Complex operating in Colombo in the 1980's.

As indicated earlier apart from the airport Duty Free Shop, another shop although not entirely duty free, but with a standard duty of 25 percent for all goods purchased with foreign currency, was opened in the 1970's at Chatham Street, Fort, and run by the Hotels Corporation, mainly for the benefit of tourists. There was also the airport shop which was entirely duty free and primarily intended to attract tourists, foreigners, transit passengers and nationals on holiday. But, these shops made no significant impact on the potential custom from tourists and

other foreigners and nationals on holiday who still preferred to do their buying of duty free goods in more attractive locations.

Throughout the 1970's Sri Lanka's duty free shops offered no competition to the shopping facilities in Hongkong, Singapore, Penang, Schipol, Karachchi or Dubai. Despite its favourable position geographically, Sri Lanka failed to attract even a small part of a steadily growing international duty free trade and therefore missed an opportunity of enhancing its foreign exchange earnings.

Moreover, the level of turnover and profit at the existing shops was negligible. The duty free prices, any where in the world, would include a price mark-up. But the net profit made by the Chatham Street tourist shop with only 25 percent duty was very small. The net profit for the year 1979 was Rs. 254,274/- (US\$ 16,950 approx.) and in 1981 Rs. 380, 435 (US\$ 21, 135). This was a comparatively negligible amount.

With the boom in Middle East employment at the start of the 1980's it was realised that Sri Lanka was missing still another opportunity. Thousands of Sri Lankan workers were finding employment in the Gulf states, but unlike the professional and traditional upper income types who went abroad earlier, these workers were most enthusiastic about their purchases of consumer durables. They used most of the earnings they had saved to purchase radios, cassette recorders and other electrical goods but they by-passed Colombo and generally went on to Singapore to get the goods of their choice.

#### Opening of new Colombo DFS Complex

Apart from the need to attract more of the earnings of migrant workers back to Sri Lanka there were

many other reasons advanced for giving the country's duty free shopping system a new lease of life. The increasing tourist traffic from neighbouring countries, India particularly, and the enhanced exchange quotas given to these tourists presented Sri Lanka with another opportunity for more foreign exchange earnings. With several big foreign funded projects being mooted there was also a fast growing expatriate community in the island; while more Sri Lankans who were living abroad were availing of the relaxed travel regulations to visit the country of their birth. Furthermore, it was found that wages and other costs in the Asian countries where successful duty free shops were located, were moving up faster than those in Sri Lanka and there were possibilities for attracting part of their custom using our comparative advantage of cheaper rentals and labour costs.

A strong case was made for setting up of a more sophisticated and competitive duty free shopping complex and the Ministry of Trade and Shipping was granted government approval to 'go ahead' with it. It was decided that space of about 35,000 sq. ft was needed for the complex. The airport at Katunayake could not provide it and the choice fell on the 5 floor building at Kollupitiya. On October 30, 1981 the Duty Free Shopping Complex was opened at this central location in Colombo.

A duty free shopping scheme had been under consideration since the mid nineteen seventies, yet no action was taken because the government at that time was not decided on the issue and also because of the restricted economic policies towards imports. There were two suggestions on where to start this venture. The first suggestion was to start it in Colombo and the second was to open four Duty Free shops in four tourist resorts; but operating such a scheme along with

the numerous import controls under the existing policy was considered a major problem.

With a change of government in 1977, however, overall policy changes and measures were adopted to liberalise trade in accordance with the new economic policy. As a first step the existing controls and regulations were completely abolished. Any person was now free to import upto a certain value under Open General License. Another step in this direction was the establishing of the free trade zone at Katunayake. The opening of the 'Duty Free Shopping Complex' may be regarded as a further step in these liberalised economic policies of the government.

The foremost objective of this new DFSC was, in the words of the then Minister of Trade, to impart a consumer satisfaction, give an impetus to trade and be of immense service to the country's economy by earning a rich slice of foreign exchange. The new venture is the first full blooded move in the country for Duty Free Shopping".

The Minister made a more eloquent plea for the complex on another occasion when he said "Any-where in the world it stands as a brave symbol of free open market enterprise where persons travelling abroad with foreign exchange could buy what they wished with their foreign currency, at dutyless prices. The idea of opening this complex on local soil was to divert foreign exchange that would otherwise have been spent in Singapore or Male or elsewhere by returning expatriates to their own homeland".

#### Something Different

"At the cheapest prices the widest range of products" was the objective of Ministry of Trade at the time of opening this venture. In keeping with this objective the infra-structure

for the shopping complex was provided by the government on a no profit no loss basis. The intention was to ensure that the overhead costs of the allottees were kept at a minimum.

The specific objectives of the Complex and organisational details were spelled out as follows in a statement by the Ministry's Additional Secretary on the occasion of its opening.

"Our objective is to attract duty free shoppers by offering at the cheapest prices the widest range of products saleable to duty free shoppers.

To achieve the objective, we had at the outset to ensure that all reputed products will be available for sale at the cheapest prices. Hence, it was decided to allocate shops to sole agents or sole distributors of reputed products on the basis that it is they who will be in a position to offer the most competitive prices since they as sole agents and distributors get the best prices from suppliers.

The infra-structure for the shopping complex will be offered by the government on a no profit/no loss basis to ensure that overhead costs to the allottees are at the lowest level.

Arrangements have been made to permit the facility of importing on special concessionary credit terms from suppliers, goods to be sold in the duty free shops for foreign exchange.

Customs and Exchange Control formalities have been kept to a minimum consistent with over-all control to ensure that the goods imported for the duty free shopping complex will be sold only against foreign exchange and only to categories entitled to duty free privileges.

Goods in commercial quantity will normally not be handed over the

counter to purchasers but will be delivered at the air port/ sea port for direct re-export.

The customs department will exercise checks at the air port/ sea port to ensure that goods sold for re-export are re-exported by the purchasers. A custom office has been established at the duty free shopping complex itself to expedite formalities and exercise supervision.

In the case of "incoming residents" the lowest duty free entitlement has been doubled from Rs. 1,000/- to Rs. 2,000/- for purchase from the Sri Lanka Duty Free Shopping Complex. This would mean that if an "incoming resident" makes purchases abroad he will have an entitlement of Rs. 1,000/- while if he makes his purchases from the Sri Lanka Duty Free Complex his entitlement will be Rs.2,000/-.

By selecting a large number of allottees to run these shops who are agents for different brands, a competitive situation will be created resulting in the consumer having a wide range of goods from which to select at different prices. This will also ensure that allottees will have to charge the lowest margins and depend on "turn over" for profits.

A sustained advertising campaign will be launched both here and abroad not only to draw personal shoppers to the duty-free shopping complex but also to attract "mail-order business" in which there is vast potential. This is the beginning".

A large number of shop allottees were permitted to sell similar products with the competition among each other to ensure the lowest possible price. In the meantime an intensive publicity campaign was launched both in Sri Lanka and abroad to draw the attention of duty free

shoppers. There was also a plan to start a "mail-order business" for duty free goods but this proposal has not been implemented yet.

### Overview

The Duty Free Shopping Complex could be identified as a pioneering venture in collaboration, between the government and private sector. Thus, while the government provides the infrastructure facilities for the Complex the private sector runs the shops within it.

After the complex was opened in 1981, it became quite popular among incoming Sri Lankans as well as foreigners. The prices of goods offered, less duty, were very attractive and well behind open market prices; and in some instances the prices were less than prices in Singapore. Shops were kept open from 9 a.m. to 7 p.m. for 6 days of the week and customers wishing to buy goods, could buy them over the counter for foreign exchange without any difficulty. At the outset there were no gate restrictions or personnel restrictions and anybody who wished to go in could do so, whether they had any exchange entitlement or not. Large numbers of those who earlier travelled to Singapore or Bangkok were now attracted by this new venture located in a 4 storeyed building at Kollupitiya.

The regulations covering imports, purchases and payments (See Box) were laid down very clearly and were amended occasionally to suit changing situations. Figures from the records of the shops in the Complex show that at the beginning of 1983 the number of persons who entered the DFSC between January and April 1983 average 31,000 a month. The average monthly sales during this same period was Rs. 132.6 million with some individual shops recording about US\$ 70,000 for a days collection.

Among the goods available are a variety of television sets of sizes varying from 12 to 26 inches and costing upto about US\$ 600, video cassette decks, tape recorders, mechanical grinders, fans, cameras, air conditioners, electric shavers, calculators, musical instruments such as guitars, pianos and organs; fridges, washing machines, carpets, perfumes, textiles and garments, elegant over-coats and blankets from Kashmir, soft toys and games, different kinds of Whisky and other liquors and various makes of foreign cigarettes and tobacco, plastic equipment and kitchen utensils.

But this streamlined venture did not continue to run in accordance with the ideals of its founders for more than a few months. No sooner had its functioning been sized up than the "cloak and dagger men" were observed moving into action.

Smuggling or the illicit trade in goods, bullion and currency has been one of the less salutary features of trade among many business communities. Smuggling has been long known in Sri Lanka too, though in recent decades it appears to have attracted much attention and gained in proportion. Many of these elements have exerted influence in the local business community too and when the suggestion for the complex at Kollupitiya first came up it was elements such as this who opposed it.

But ultimately when the venture began functioning, disregarding their protests, some of these very same elements decided to get into the duty free shop business following the principle that 'If you cannot avoid getting beaten by them you better join them'.

It is elements such as these who were quick to look for the loopholes and exploit them to their own advantage. Duty Free goods, meant to be traded for foreign exchange, soon found their way into the open market

and could be bought in local currency at a 'price'.

Action had to be taken and three shop keepers at the D.F.S.C. were seriously warned by the Ministry of Trade for the first time in March 1982 (after three months of the opening) for intentionally bending the rules under which they were allowed to do business within the Complex. The three shops were all big names in business, with international connections.

But that was only the beginning. By 1982 it was common knowledge that there was an organised illicit trafficking of goods by groups of racketeers who moved at will in and out of the Complex. There were reports that smugglers who carried on their activities between Sri Lanka and Singapore turned their attention to these shops and met with hardly any obstacles. It was not difficult for a person to purchase anything from the DFSC via these racketeers. They even formally setup shop, keeping their assistants on the main road opposite the DFSC with a price list and a calculator to give bargain hunters possible prices and collect their orders, while they were busy collecting black money and making purchases inside.

Such was the situation at this time that it was officially confirmed in a reply given by an assistant liaison officer (an employee of the Complex administration) to a writer who made certain allegations against the Duty Free Shop administration. This reply appeared in the Daily News of March 26, 1982.

The following charges were made by a shopper against the restrictions introduced in 1982 on those wishing to enter the DFSC. "Nowhere, in the world is a customer asked to pay to enter a shop; nowhere in the world is a customer not permitted to take his wife into the shop". The liaison officers reply was as follows:

"To both these allegations I would like to ask him one question. If he

was aware of any duty free shop in the world where racketeers dominated, thuggery and corruption was at its highest level, a place which within 3-4 months had become the distribution point of black money and forged currency, an international show place which had ultimately got labelled a "racketeers" paradise. We had a place like this in Sri Lanka till 1.3.1982". (before enforcement of new entry restrictions).

In an attempt to curb the activities and abuses of the "racketeers" (as they were called) the authorities brought in new measures to restrict entry into the DFSC by introducing an entrance fee of Rs. 20/- per person. It also restricted entrance only to passport holders. The exchange between the writer referred to above and the liaison officer of the DFSC came about following the introduction of these two new regulations.

Duty free traders commenting on these restriction state that there are no such curbs on movement of shoppers exercised in any other duty free centre in the world. They argue that the concept of duty free is nullified when a fee has to be paid by a customer to trade. However, the situation had so deteriorated that the authorities had no other way of shutting out the unnecessary crowd that crept into this place and helped, the 'racketeers' in their activities.

The second restriction of disallowing any person other than a passport allowance holder to enter the complex caused much difficulty for genuine customers. As a result of this regulation a husband attempting to use his hard earned money from abroad could not take his wife with him to these shops to choose her desired utilities for her household. Normally, such purchasing is done by the wife who enjoys selecting items for the household, as one form of relief from her routine household work. But with this restriction a husband loses the chance of having his wife and children accompany him on his shopping spree.

Yet before these restrictions were introduced the corridors of the five floors of the Kollupitiya DFSC were packed with non-customer traffic, leaving hardly any room for genuine customers to move on. The two new restrictions helped to relieve such a situation.

### Cost and Benefits of the DFSC

A government levies duties on imports for two basic reasons. Firstly, they are widely accepted as the most convenient means of raising revenue for the government, and secondly, they offer deserving or underserving protection to industries in the home country.

The extent to which a government would go in imposing duties on imports depends on its belief in free trade by that government. The fastest moving goods in the duty free shops are normally those whose duty rates are high and from which government received high revenues. The government therefore took a calculated risk in the belief that the revenue lost from import duties would be covered by the foreign exchange earnings from the duty free shops. Every time a Sri Lankan or foreign consumer purchases a duty free good from within the DFSC or outside there is a loss to revenue. This revenue is the import duty that the consumer would have paid had he made his purchase from the open market.

Most of the items imported by shops in the duty free complex are subject to duties of hundred percent or more if they come in through the open market. Estimates have been based on the assumption that at least 75 percent of the value had to come into government coffers as duties on each item if imported duties were charged. The value of imports into the duty free shopping complex for the year 1984 was Rs. 829 million and it may be assumed that if at least 75 percent of these goods were charged a duty about Rs. 642 million would have accrued to government revenue.

*(continued on page 10)*

## DFSC IMPORT, PURCHASE AND PAYMENT REGULATIONS

### Imports

Duty Free shop holders will be permitted to import their requirements on 180 days D.A. Terms (Document and Acceptance) with Letters of Credit. However, where the exchange control so permits, D. A. Terms will be allowed without Letters of Credit. Such imports should be strictly for sales at the Duty Free Shops. The goods imported for D.F. Shops should be cleared on bonding entries only. If any person is found to default in complying with these conditions his D.A. Terms will be withdrawn. The shoppers can import only the listed items allowed by the Ministry of Trade. A Bank guarantee should be given for each item. Each shop gets a Bank guarantee for Rs 50,000/- for their shop and Rs 1,000,000/- for the bonded warehouse which is a concession given only to the Duty Free Shop owners.

The D.A. Terms mentioned above means that Sri Lanka's Duty Free Shop importers are allowed 180 days or 6 months credit from their imports. Therefore the foreign exchange to be paid to them can be saved here for that period which is a big gain in foreign exchange. The shop owners also can settle payment sometime after selling their imports.

### Payment for Purchases

Only the following form of payment can be accepted for any purchases made at the Duty Free Shops.

1. Foreign Currency (Cash)
2. Travellers cheques
3. Cheques drawn on non-resident foreign currency accounts and External Accounts.
4. Credit Cards specified by the controller of exchange.

No other personal cheques are accepted. Certain currencies prescribed by the Controller of Exchange are not accepted and these are notified from time to time.

Each shop is given a Foreign Currency Imprest by the Controller of Ex-

change to enable them to return balance money to the customer for their payments on purchasing. A monthly statement has to be furnished to the Controller of Exchange every month on their transactions.

### Requirements for Sales for the different categories of customers

1. All foreign passport holders not claiming Duty Free Concessions under any other category of personnel listed here.
2. Diplomatic personnel.
3. Foreign personnel employed in development projects in Sri Lanka.
4. Incoming residents (Sri Lanka passport holders).
4. Foreigners with resident visas.
5. Incoming residents (Sri Lanka passport holders).

There were inquiries from operators in some countries in South and East Asia who desired to run shops in the complex; but it was decided not to permit foreigners operating shops in the DFSC.

### Entitled Categories of Personnel

#### Tourists

Sales of non consumable items to tourists at the DFSC are allowed only on the basis that those items will be taken with them when they leave the country. These items can be used during their stay in the country. The sales of such items are expected to be noted in their passports.

There are no quantitative or other restrictions regarding items sold for delivery at the airport.

#### Diplomatic Personnel

Diplomatic personnel are allowed to buy anything without restrictions, if they have got the item-wise clearance certificate

from the Ministry of Foreign Affairs. The customs officers in the complex maintain a record of diplomatic personnel buying, to check any malpractices occurring.

### Foreign Personnel Employed in Projects

If these persons possess residence visas for six months and over they are treated similar to incoming Sri Lanka residents and are entitled to a maximum baggage concessions granted to incoming residents.

If such persons desire to purchase goods to be taken out with them when they leave at the end of their stay, such sales are treated as sales to tourists.

### Incoming Residents with Sri Lankan Passports

All incoming residents with Sri Lankan passports need to get a Duty Free Baggage allowance endorsed on their passports by the Customs Department. Deductions are made for all baggage previously cleared against their allowances and only the net amount entitled could be used to buy in the DFSC.

### Sales to Sri Lanka Passport Holders on a Temporary Visit.

Such persons who have no Duty Free allowances can purchase at the Complex, but the goods are delivered to them at only the airport, at the time of departure. They are however, entitled to the consumable items applicable to tourists, under the approval of the customs.

### Sales to Foreigners with Resident Visas for 6 months and over

Foreigners residing for employment in projects here are permitted a Duty Free Baggage allowance of Rs 20,000/- each for two adult members of a family and an endorsement about the goods bought by them is made in their passport. If they have already used a part of their duty free baggage allowance at the airport, then only the balance can be used for DFSC buying.

### Limitation of Baggage Allowances of DFSC

- A. Baggage of persons returning to Sri Lanka after a period of stay abroad of less than ninety (90) days is entitled upto Rs.2,500/- if he does not bring anything

on this allowance he is entitled to buy upto Rs 3,750/- from the Colombo DFSC.

- b. After a period of stay abroad of (90) days and over but less than (365) three hundred and sixty five days his entitlement goes upto the value of Rs 12,500/- for shopping in the DFSC.
- c. After a period of three hundred and sixty five days and over, he is entitled to buy goods upto a value of Rs 25,000/-

Earlier the baggage allowance authorised for a Sri Lankan who travelled abroad and returned to the island staying less than 90 days was Rs 1,000/-, and more than 90 days and less than 180 days Rs 5,000/-. After a period of stay abroad of 180 to 365 days Rs 10,000/-, 365 days to 730 days Rs 15,000/-, and over 730 days Rs 20,000/-. But since then the authorised allowances were increased to these levels to offer more inducements to buy from the DFSC.

At the early stages of the DFSC goods could be purchased from the DFSC for travellers cheques and foreign currencies such as US. Dollars and Sterling Pounds by both Sri Lankans as well as the foreigners; but no sooner some shop owners and other unscrupulous elements started using forged 'black' foreign currencies to obtain duty free goods from the shops and sell them outside at high profits, the Government introduced new regulations specifying that only travellers cheques should be accepted from Sri Lanka.

This requirement was introduced from March 1982, only 5 months after the opening of the DFSC. An entrance fee of Rs 20/- was introduced for each customer who wished to enter the premises. Foreign tourists however, were allowed to make their payments using foreign currencies.

Earlier the free baggage allowances for duty free shopping authorised for Sri Lankans was valid 180 days; but this was reduced to 90 days by the Minister of Finance in his Budget Speech for 1985.

#### Quantity Restrictions

The list given below indicates the limitations in the number of each item that could be purchased by a single customer. As mentioned before a tourist can buy only the consumable items - liquor, cigarettes, cigars and tobacco, perfume and chocolate etc. come under this category. Any other durable item bought by a tourist, must be taken out of the country when he leaves. If not, he has to pay the normal import duty imposed on that particular item.

#### LIST OF QUANTITIES TO BE SOLD TO EACH SRI LANKAN PASSPORT HOLDER

1. Electrical items or electronic items	1
2. Electrical fans, table, ceiling or pedestal	1
3. Cassette tapes	6
4. Video Cassette tapes	3
5. Pocket radio	1
6. T.V.	1
7. Calculator	1
8. Gas Cooker	1
9. Pressure Cooker	1
10. Rice Cooker	1
11. Dinner Sets	3
12. Glass Wine Set	3
13. Cutlery Sets (each of knives, spoons, forks)	6 (1 set)
14. Tea set	3
15. Fountain Pens	3
16. Ball Point Pens	3
17. Wall Clocks	1
18. Clock (Desk or Alarm)	1
19. Camera	1
20. Toys	6
21. Umbrellas	3
22. Garmets	3 pices
23. Blankets	6
24. Razor Blazers	6
25. Film Rolls	1
26. Brief Cases	1
27. Suit Cases	3
28. Wrist Watches	7
29. Toilet Preparations	3
30. Toilet Soap	3
31. Toilet Powder	2
32. Torches	2
33. Musical Instruments	1
34. Key rings	3
35. Air pots	1
36. Typewriter	1
37. Photo Album	3
38. Telephone	1
39. Footwear	3
40. Records	3
41. Weighing Scales	1
42. Vacuum Flasks	1
43. Spectacle frames and lenses	3
44. Smoking Pipes	3
45. Shaving Sets (Electric)	1
46. Shaving sets (Non- electric)	2
47. Hand Bags	3
48. Cigarettes	200 or 50
49. 2 regular size bottles of wine and one and a half litres of spirits. Beer Cans (Half a case)	
50. Toilet water not exceeding a quarter litre and a small quantity of purtume	

- \* All items unlisted should be sold at the rate of 1 unit per customer. All items sold in excess of these quantities should be delivered at the point of embarkation only.

#### LOCAL INDUSTRY AFFECTED

The Chairman of Siedles T.V. Industry Limited, the local firm attempting to compete with the imported product and build up an indigeneous T.V. hardware Industry, has drawn pointed attention to the availability of duty free imported sets on the local market and the threat such imports pose to local industry. The 1984 restrictions imposed at the D.F.S.C. appear to have afforded some relief to the local industrialists. To quote the Siedles Chairman-

*"One of the biggest problems we faced earlier was the unfair competition" we had from imported TV sets which found their way to the open market at more or less duty-free prices. Needless to say, this affected the sales, particularly of our 20" model which was introduced to the market at the end of 1983. The bulk of the stocks we had on our hands at the commencement of the year represented this model.*

*In this context, I must say that the introduction of stricter controls by the authorities at the Duty Free Shopping Complex towards the end of 1984 was an obvious boon to local industry. The changed circumstances contributed to an appreciable upturn in our sales.*

**PAYABLE DUTIES (ESTIMATED) 1982-83**

(Summary of values and payable duty on goods imported by duty free shops for period of one Year from 01.06.82 to 31.05.83)

	(Rs. '000)	
	Total Value	Duty Payable
Liquor	13,960	26,111
Cigarettes & Tobacco	6,650	33,252
Wrist Watches, Wall Clocks etc.	56,673	53,107
Radio Receivers and Television Sets	414,457	317,678
Video Decks	106,126	63,675
Electrical Appliances and Household Goods (Electric Cookers, Blenders, Refrigerators, Fans, etc.)	147,865	147,990
Gas Cookers	32,355	11,324
Glassware	16,236	16,236
Musical Instruments	4,195	2,517
Textiles & Garments	38,084	81,826
Calculators & Adding Machines	12,919	7,692
Camera & Photographic Equipment	10,177	6,330
Film Rolls & Cassette Tapes	31,512	18,374
Perfumes	8,475	42,374
Confectionery	894	894
Jewellery (Imitation)	197	197
Cigarette lighters, Thermos Flasks & Jugs, etc.)	2,877	1,814
<b>Total</b>	<b>901,652</b>	<b>831,390</b>

The table above indicates the official value of Duty Free imports for the Colombo DFSC during the 12 months from 01.06.1982 to 31.05.1983 and the duty payable on these imports during this year. According to these statistics Rs. 901.7 million worth of goods had been imported. The highest value for items, worth Rs. 414.5 million were recorded for the Radio Receivers and Television sets sector, with second largest imports worth Rs. 106.1 million being recorded in the Electrical Appliances and Household Goods sector. Wrist Watches and other clocks, as well as the Textiles and Garments recorded consi-

derably high imports compared to the other sectors.

The loss to Government Revenue from duty free perfume imports was as much as Rs. 42.4 million. This was the item where duty payable was the highest for any single item.

The total duty payable which did not accrue to Government Revenue was Rs. 831.4 million. This figure was more than the total government expenditure of the Hospital and Health Services for 1985 which amounted to Rs. 806 million, according to the Government's Estimates of Revenue and Expenditure for 1986.

It is necessary, however, to consider whether all the transactions that generated such profits were "genuine". If the buyers were "genuine" and transactions within the law the country's economy would have stood to gain, but if the reports of all the malpractices purported to have taken place in the DFSC were correct the benefits to the economy would have been minimised. ("Genuine" buyers are those foreign nationals and incoming residents who purchase goods with their own exchange generally for their own use and not those who purchase with illegal money and do so for purposes of trade.)

The possibilities of a large number of illegal transactions taking place seems to be evident in an analysis of the sales figures of some Duty Free Shops in the DFSC during 1984. These figures give the position during two different periods namely:

1. When sales and deliveries over the counter were taking place.
2. The 4 months after August 1984 when delivery of purchased items was only from the Port premises.

On the other hand it can be argued that when comparing the value of imports into the duty free shopping complex, with the sales there has been a considerable profit and gain in foreign exchange to the country. The following figures will illustrate this position more clearly.

The total sales made by the DFSC in the year 1984 was Rs.1,048 million. These imports and sales generated a profit of Rs. 426 million (Sales value less Import value) which amounted to a 51.4 percent in foreign exchange.

**Table 2 Value of Sales of Some Shops in the DFSC in 1984 (Rs '000)**

	Shop A	Shop B	Shop C	Shop D	Shop E
January	3,356	3,338	3,326	1,246	3,992
February	3,905	3,327	2,817	995	3,245
March	2,364	2,219	2,627	1,024	1,655
April	2,932	3,715	2,549	1,017	1,787
May	2,507	2,563	3,201	1,175	2,426
June	2,225	1,853	2,741	686	4,065
July	1,496	1,860	3,010	713	2,691
August	769	916	2,460	479	1,305
September	36	396	249	76	125
October	203	1,467	2,199	359	1,038
November	1,275	748	2,180	297	441
December	441	457	1,421	292	493

The DFSC sales have always been open transactions as in any other shop where goods may be purchased. Upto August 1984 collection and delivery of purchased items was also as in the open market where customers could pay and collect their items over the counter. Abuses in this 'open system' led to a change in the procedures.

The malpractices within the whole system kept increasing since the DFSC began operations in October 1981. As generally happens, certain restrictions became necessary after a few months of DFSC operations; the restrictions being the need to produce a passport at entry point; passport holders to have their exchange entitlements marked on the passport; and charging of a fee of Rs 20/- for entry. Those abusing the free and open entry system were quick to find means of getting round these restrictions. It was necessary for such elements to make their way into the DFSC each day; as their illegal transactions, in connivance with some shop owners and even officials, had now become an organised business.

When public pressure against such abuses grew too strong there was an official clamp down and the Ministry of Trade and Department of Customs warned some of the shop owners and even ordered closure of some shops owing to their illegal activities. But steps to eradicate completely the malpractices taking place could have seriously affected business within the Complex and therefore the authorities faced the two extreme situations of either closing down the complex or moving it out of 'town' into the airport premises; or on the other hand allowing the complex to stand where it is and turning a blind eye to the malpractices. The in-between position however was adopted, which was to introduce further restrictions and these inevitably have led to much controversy. From August 1984 the authorities introduced three new restrictions:

## DUTY FREE TRADERS PROTEST-THREE CHANGES AFFECTING BUSINESS

Three changes in procedures were introduced at the DFSC from 1984 with a view to reducing malpractices and tightening up controls. These include (a) delivery and collection of goods purchased at the DFSC from the customs premises in the Port, (b) bringing the bonded warehouses under dual control, (c) stopping re-bonding. These three new regulations irked the DFSC traders who protested. Reasons for their protests are given below.

"In the case of the first change, the main problem arising from the requirement that delivery can only be made at the T-2 Warehouse in the Customs premises is that several customers are not prepared to suffer the inconvenience of making this extra journey and going through the time consuming procedures and documentation necessitated thereby. Also, we have had several complaints from customers that the goods delivered to them are found to be damaged or some of the contents pilfered. The damage is caused in the process of loading, unloading and storing the goods for delivery at the Customs premises, and this usually happens with fragile items like glassware. The pilfering takes place with goods like packages of chocolates, cigars, cigarettes, beer and liquor. Furthermore, we have noted from the reaction of customers that they are reluctant to make purchases of expensive and delicate items like watches, cameras, jewellery, etc. when they are not able to take immediate delivery, but must await delivery elsewhere with the uncertainty of not knowing when and in what state it will be made.

The delivery of goods from the shops was stopped because the Customs Officers complained of the large number of touts and brokers who were both inside and outside the Complex, waiting to acquire the sold goods from those customers who purchased only to re-sell. But we note that these same persons have managed to gain admittance to the Customs premises with "passes" and they are even there with their vehicles to help customers transport their purchases of items such as fridges, TV receivers, air-conditioners, etc. It then raises the question whether it is reasonable to persist in a procedure which deters customers and reduces business.

The second change requiring dual control of the bonded warehouses leads to unnecessary delays by us having to wait for Tide-Waiters, sometimes resulting in the loss of sales. The cost of opening a warehouse is now Rs 100/- per visit. This makes it most uneconomical as several such trips are re-

quired due to the lack of storage space in the small area allocated for each shop.

The third change stopping re-bonding affects us thus. Prior to this stoppage, purchases were made by us by negotiation in respect of quantities in bulk such as container loads. This practice enabled us to obtain rock-bottom prices on certain items resulting in our shops being the cheapest duty free shops in the region, and this attracted several foreign buyers from neighbouring countries. We were able to help each other by re-bonding the goods we did not deal in and passing on the credit facility obtained when ordering on D.A. terms permitted by the Controller of Exchange. The stopping of re-bonding now prevents us negotiating for purchases in bulk quantities and thereby, our prices have increased, making us less competitive with the duty free shops of other countries in the region.

In addition to the adverse consequences of the above three changes introduced after the 'acid throwing' incident, we are also badly affected by the B.T.T. levied on our sales. The 10% turnover tax has resulted in our having to hold over our stocks as the duty on duty paid items for the local market has also been reduced. We find that some items we stock such as calculators are cheaper in the local market. Hence, we lose customers as even foreigners are aware of the local prices outside the Complex.

For the above reasons, we find ourselves now in a very grave financial situation. We were, as it is well known, carrying stocks costing several millions ordered in good faith and in the hope that we would be allowed to continue to trade on the terms and conditions operative when the Complex was established. These new restrictions have brought us to the point of not being able to finance our businesses and even the commercial banks appear to have lost faith in the economic viability of the Duty Free Scheme as presently operated since they refuse to extend any further assistance or facilities to us.

1. All goods sold from the Duty Free Shop to be delivered to the Customs at the Colombo Port premises and collected by shoppers only from there.

2. The bonded warehouse previously in the hands of shop owners were brought under the dual control of the Customs and shopowners.

3. Re-bonding was no longer permitted.

The Duty Free Traders Association maintained that these measures affected their business and gave their reasons in a strongly worded protest. (See Box).

An analysis of the sales statistics in the Table at right shows the heavy drop in sales after August 1984 in the shops within the Complex. A comparison of the sales from these 5 shops in the months of July and August shows that sales had dropped to 48.6%, 50.8% 84.2% and 51.5% respectively in the month of August. The figures also reveal that the drop continued for some shops after August. One view was that a part of the sales before August were not 'genuine' transactions, and the nearly 50 percent drop in sales were largely this type of transaction. The other view, however, is that the restrictions kept out shoppers. Apart from the inability of shoppers to go into the Complex freely, and restrictions on shop owners moving their goods as they wished from their bonded stores, other factors such as the drop in tourist traffic and a slower in-flow of the returning migrant workers have also contributed to the drop in sales.

The Duty Free Traders Association maintained that 30 of their 36 members had an over 40 per cent drop in sales after the restrictions were brought in. Of these 30, as many had 13 shown a drop in sales of over

60 per cent and 7 a drop of as much as over 80 percent. The traders also released figures (given below in Table 3) of shoppers visiting the DFSC before and after the restrictions, stating that these measures had caused a heavy loss in trade for them.

According to this table the inflow of local customers has dropped nearly 50 per cent while the number of foreign customers dropped almost 60 per cent. However, it is difficult to imagine that such a large number of

operations of the DFSC? With all the abuses of the system it is hard to see how the estimated 51.4 percent profit in 1984, of the DFSC, could have been a foreign exchange gain to the country.

Had duty been charged all these imports may not have been made, but once they were made the country was deprived of all duties. For 1981- 82 the possible amount of duty payable was over Rs 800 million.

Table 3 Number of Customers Visiting the DFSC Before and After the New Restrictions were Imposed

Month	Local	Foreigners	Total
<b>Before Restrictions</b>			
January 1984	11,290	9,809	21,099
February	7,991	9,293	17,284
March	7,736	10,247	17,983
April	7,313	6,657	13,970
May	8,694	6,324	15,018
June	9,769	7,532	17,301
6 month total	52,787	49,862	102,655
<b>After Restrictions</b>			
January 1985	6,377	3,429	9,806
February	3,700	2,919	6,619
March	4,400	3,051	7,451
April	4,795	3,600	8,445
May	4,460	3,920	8,380
June	(4,025)	(2,344)	(6,369)
6 month Total	27,757	19,263	47,070

genuine local customers would forego use of their duty free allowances merely because of the restrictions. Some argue that it was more likely the fall in traffic was the result of a drop in the entry of un-authorized persons who visited the Complex for the purpose of illegal transactions; while on the other hand the drop in foreign customers was related to the drop in tourist arrivals.

All were in agreement, however, that there were severe malpractices in the entire system - the authorities saw it and the traders admitted it. The vital question then was - did the country's economy benefit from the

There was still another way in which the economy and the country were not benefitting up to 1985, and that is through the loss of turnover taxes. All other business establishments paid BTT on their sales, but not the DFSC shops till the Minister of Finance introduced a 10 per cent levy with his 1985 Budget. In making his case the Minister said:

"At present goods sold at the Duty Free Shopping Complex are completely free of import duty and turnover tax. These goods can, therefore, be sold at very low prices. The prices at the Duty Free Complex in Sri Lanka are in most cases lower than those in other duty-free shopping centres. Many of the items purchased

at the Duty Free Complex are often re-sold at a profit of around 20 per cent. I am of the view that it should be possible to impose a turnover tax on goods sold at the Duty Free Complex without unduly depressing sales. Such an imposition would also afford some relief to local manufactures, some of whose products compete with products sold at the Duty Free Complex. I propose, to levy a Turnover Tax of 10 per cent sales in the Duty Free Complex. I anticipate a revenue of around Rs 100 million from this source".

This statement also supported the view that a good part of the merchandise coming into the Duty Free shops were being sold in the open market at a profit of at least 20 per cent, though trade sources placed it at an even higher level.

According to some sources more than 50 per cent of the Duty Free sales were channelled on to the open market for re-sale; the items entering the open market being mostly electronic equipment, liquor and glassware. However, most of the foreign liquor (Whisky, Brandy, etc.) did not go straight into the open market but to the affluent who had arrangements with the brokers to get it into their hands. Local industries, such as the local liquor and distillery industry could have been affected. Clear evidence of such an impact was seen on the local TV set assembly industry. (See Box)

A further likely loss of revenue: as a result of DFSC sales may be estimated from the Customs Statistics for 1981 and 1982. The 1981 imports of Whisky and Brandy were valued at Rs 14.9 million and Rs 7.6 million and import duties on these were Rs 19.8 million respectively. In 1982 the value of imports went upto Rs 33.6 million for Whisky and Rs 11.9 million for Brandy; but the revenue during this year was only half the previous year for Whisky (Rs 10.6) and for Brandy only (2.8 mn) (Sunday 24.3.83).

There was strong evidence that liquor had been smuggled out by the case load when it was transported from the Customs bonded stores to the Duty Free Shopping Complex. But no action could be taken on this because all the paper work was ready to prove that these cases of liquor were brought to the DFSC and sold.

Whisky sales in Sri Lanka doubled in 1982 according to the sales figures of the Scotch Whisky Association of UK, going up from 25,000 to 48,000 cases. But dealers outside the DFSC were not at all happy about it. Their records did not reflect any increase in business despite a drastic drop in the type of liquor sold in the Duty Free Shops (CDN 22.1.83).

On this basis the Government could be losing several millions of rupees by way of revenue through such leakages of goods imported for the DFSC. These goods ultimately reach the open market though they were intended to go into the hands of passport holders with foreign currency.

A further effect observed was that who imported goods for resale in the open market and paying the usual duties were badly affected as they could not compete with the same goods channelled into the open market from the DFSC. Some of the traders who hitherto were in the import business found it essier to obtain and sell duty free goods.

In 1984, there was also a drop in proceeds from excise duty on locally made foreign type liquors (Beer, etc.) and this was attributed to the competition from DFSC sales and the government had to bear an estimated loss of Rs 90 million. In the meantime price of local-origin of liquor, such as coconut arrack, which is consumed mainly by the less privileged was increased by Rs 6/- per proof litre (up from Rs 3/- per bottle) in order to raise government revenue to cover the excise duty loss from foreign type liquor.

In 1983, action was taken by the Ministry of Trade to close down one shop for selling six bottles of 'Liquor' to a Sri Lankan who was not entitled to any duty free allowance.

There were innumerable instances when malpractices were reported from the DFSC.

Despite all restrictions it was not possible to prevent goods from leaking out. Even today it is not uncommon to see various luxury items meant for the DFSC available in the local market. There are some unscrupulous businessmen and shop owners in the city who would offer any specific item available at the DFSC at a slightly higher price and these prices are certainly more attractive than on those goods for which even 100 percent duty has been paid officially. Some of them openly have a list of items available and even arrange for delivery together with a bill issued from the Duty Free Shops that trade in these items. This illegal traffic in duty free goods has roused protests from local manufacturers who find their business affected. They

complain that they pay duty on imported components and their products and if they are to compete they should be entitled to a rebate on this duty.

### New premises at Hotel Ramada Renaissance

With increasing illegal activity being reported at the DFSC there were proposals from time to time to shift the Duty Free Shopping Complex to various places. The first proposal was to shift from its location at Kollupitiya to a site at the former Havelock Race Course at Reid Avenue, where there were plans to put up a complex with ultra modern facilities. Another proposal was to shift the complex to the Colombo Airport at Katunayake where intensive airport security and restrictions on movement could be applied. This site was strongly recommended after the incident where a customs officer attempting to enforce the rules was the victim of a can of acid thrown at his face.

Meanwhile, construction work was completed on the Trans Asian Hotels Ltd., a joint venture of the American Hotel Ramada Renaissance and the Sri Lanka Insurance Corporation.

The fact that the Insurance Corporation and Duty Free Shopping Complex both come under the Ministry of Trade and Shipping influenced the decision to shift the DFSC to the hotel's Travel Centre which is located in this building. The building appears to be almost custom built with central air-conditioning, escalators and more spacious facilities than that available at the Kollupitiya DFSC premises. There was sufficient room for 49 shops at these new premises but when the shifting took place in June 1985, 40 out of 42 shops at Kollupitiya shifted to these premises.

The management of the complex has from its inception continued to be in the hands of the Ceylon  
(continued on page 16)

## WORLD DUTY FREE TRADE

For more than 30 years duty free shops have served world travellers. These shops were usually located at airports, on board planes and on ferries, at national boundaries and 'down-town' in cities. These duty free shops in restricted "Free Zones"

at airports, or on board airplanes and inter-nal ferries channelled domestic or imported products to international consumers for foreign exchange. Globally and geographically the largest tax free market consisting of 60 per cent of the world's total belongs to Europe.

Spirits, perfumes and tobacco products are typical examples of what are considered "luxury products" and upon which the authorities impose high rates of tax, duty and other charges. Taking into consideration the high duties and taxes usually applied to these products it is not surprising that these often account for about 80% of the turnover in tax free shops.

Table 1 Total World Sales of Duty Free Shops

Product Group	Top 500 shops		All	
	Value US\$ Mn.	%	Value US\$ Mn.	%
Drinks	860.0	35%	1,050.0	35%
Fragrances	515.0	21%	630.0	21%
Smokes	590.0	24%	720.0	24%
Others	485.0	20%	600.0	20%
<b>Total</b>	<b>2,450.0</b>	<b>100%</b>	<b>3,000.0</b>	<b>100%</b>

Source: 'Best 'n' Most' 1984.

Table 2 Duty Free Sales by Region

Region & Continent	Top 500 shops		%Other shops US\$	World Total US\$	%
	Value US\$	%			
Nordic countries	407.0	16.6	13.0	420.0	14
British Isl.	428.0	17.5	22.0	450.0	15
Central Europe	658.0	26.8	42.0	700.0	23
Eastern Europe	22.0	0.9	8.0	30.0	1
Europe Total	1,515.0	61.8	85.0	1,600.0	53
North America	336.0	13.7	44.0	380.0	13
South America	73.0	3.0	17.0	90.0	3
Central America	15.0	0.8	25.0	45.0	1
Caribbean	20.0	0.8	25.0	45.0	1
America Total	444.0	18.1	106	550.0	18
Africa North	18.0	0.7	22.0	40.0	1
Africa Central/S	26.0	1.1	34.0	60.0	2
Africa Total	44.0	1.8	56.0	100.0	3
Middle East					
Indian Ocean	68.0	2.8	112.0	180.0	6
Near East Medi.	27.0	1.1	43.0	70.0	3
Middle East Total	95.0	3.9	155.0	250.0	9
Far East & East Asia	316.0	12.9	94.0	410.0	14
Australia & Pacific	36.0	1.5	54.0	90.0	3
Asia & Pacific Total	352.0	14.4	148.0	500.0	17
<b>Total</b>	<b>2,450.0</b>	<b>100.0</b>	<b>550.0</b>	<b>3,000.0</b>	<b>100</b>

Table 3 Sales of Merchandise Continent Wise in 1984 (%)

Continental	Drinks	Fragrances	Smokes	Others	Total
	%	%	%	%	%
Total Europe	32.2	20.9	26.6	20.3	100
Total America	40.3	20.5	19.6	19.6	100
Total Africa	34.1	13.6	18.2	34.1	100
Total Middle East	44.2	26.3	24.2	5.3	100
Total Asia & Pacific	42.6	22.5	17.6	17.3	100
World Total	35.1	21.0	24.1	19.8	100

Source: The Best 'n' Most 1984.

Frequently a tax free shop enjoys a highly international mixture of customers who together represent a very broad spectrum of different tastes and preferences. Today there are more than 500 such duty free outlets.

A survey conducted and published in Sweden's Duty Free Shop world guide series "Best 'N' Most" in DFS 1984, reveals that the world's top 500 Duty Free Shops sell tax free goods amounting to a combined value of US\$ 2,450,000,000 stated in consumer prices. Travellers spend US\$ 860 million on wines and spirits; US\$ 515 million on perfumes and cosmetics; US\$ 590 million on cigarettes, cigars and tobacco; and US\$ 485 million on other items (including writing instruments, fashion, audio, visual equipment, lighters, cameras etc.) (Table 1).

Some estimates of World total sales figures, which include all world airport shops, sky shops, sea shops and 'down town' shops have placed the figure at not less than US\$ 5 billion annually.

Tax free shops exist in more than 100 countries although not all of those countries have well decorated or well stocked outlets. Airport shops or national carriers with on board sales account for over 60% of the \$ 5 billion world duty free trade.

Table 2 shows the geographical distribution of Duty Free sales among the top 500 shops and other shops. Their distribution is based on individual shops total sales which are then added together for each respective country and presented for 5 "Continents and 14 sub-markets".

Table 3 illustrates the geographical distribution of merchandise sales among five world regions. According to this table the wine and spirits (drinks) in all markets are the most important product group and in Europe represents 32.3% of all duty free sales.

The outlet with the largest gross sales in both 1984 and 1985 has been London's Heathrow airport averaging US\$ 90 million per year. Gatwick airport in

## INDIAN SHOPPERS AT THE DFSC

Enjoying a shopping spree in India has always been a privilege of a fortunate few Sri Lankans. People from various walks of life including certain types of businessmen have been engaged in this one way stream for years. The opening of the Duty Free Shopping Complex in Colombo resulted in a dramatic reversal in numbers in the flow of traffic.

After the opening of the Colombo DFSC there began a steady trek of Indians from across the Palk Strait whose sole intention was to shop for duty free goods in Colombo. At the time this venture was opened Indian nationals were permitted to take out US\$ 1,250 for personnel expenses but from around June 1983 this amount was reduced to US\$ 300 by the Government of India. This resulted in a dramatic drop in the number of shoppers coming in from India.

There were very broadly four types of Indians who came to Colombo for shopping at the DFSC; (1) affluent Indians from the big cities, (2) middle and working class Indians, (3) school children and teachers, (4) persons hired by businessmen in the South of India to act as 'couriers'.

The largest number that came from India belonged to the fourth category. All travel arrangements, together with a meagre living allowance, was provided to them and they were despatched by train and ferry across the Palk Strait or by air as couriers for businessmen who offered them a small

U.K. which has averaged around US\$ 40 million per year is also an important outlet. The other major outlet in Europe was Amsterdam airport, which has averaged sales of about US\$ 78 million per year. The two airports in Paris the Charles de Gaulle and Orly also had a total of a US\$ 100 million in sales in 1985. Frankfurt, Brussels and Zurich were the other important continental airports. The Viking Lines of Finland, Stena Sessan Line of Sweden, Silja Line of Finland, DSB Ferries of Denmark, Sealink British Ferries of U.K. and Townsend Thorsson Ferries U.K. were other important outlets. Together all these outlets in Europe accounted for nearly 25 percent of world duty free sales.

In Asia, Singapore, Tokyo and Hong Kong airports were leaders accounting for about 15 percent of total duty free sales according to the publication 'Best 'n' Most' which lists Colombo Airport as 90 among the top 100 duty free outlets in 1985.

monetary incentive. They generally seemed to be very poor and uneducated and many were not even literate. They were totally unused to the ways of city life and in Colombo they could be seen sitting on the pavements near the DFSC and in lobbies around the Complex, poorly dressed, and even cooking their meals in the vicinity. It was not unusual to see one of them with a load of duty free goods on his head attempting to get across the busy street opposite the DFSC oblivious of all on coming traffic. The majority of Indians who came to Sri Lanka as tourists were from this category.

According to statistics of tourist arrivals during the first seven months of 1982 there were 79,692 Asian tourists visiting the country, as against 52,406 Asian visitors during the same period of the previous year. The larger number of arrivals in 1982 was identified as the increased number of tourists who were coming in from India for shopping at Colombo DFSC. Through 1981 there were 89,000 Asian tourists as against 135,000 in 1982; in 1981 only 13 percent were Indians whereas in 1982 the proportion had gone up to 21 percent. In the first 6 months of 1983 the number of Asian tourists was almost 100,000 and then the number fell dramatically.

There was a regular pattern in which these couriers who came as tourists acted for the business syndicates on either side of the Palk Strait. Their ferry or air tickets and necessary money for expenses were provided by the Indian counterpart, while the operators at this end assisted with transport, meals and lodging. These people were given lists of goods to be purchased and instructions to go to a particular shop. All procedures were attended to for them and all they did was collect the goods and get back to India as scheduled, where they handed over the goods to their principals and collected a small fee for their services. On several occasions these persons were held by Customs Officers for being involved in malpractices either at the DFSC or at Port of entry and departure. Among the most common offences were the following:

- (1) Customs at the Colombo International Airport, Katunayake found Indians entering the country without any money; they had made false declarations they were carrying US dollars. It was also found that they had attempted to smuggle Indian and Pakistani currency into the country.
- (2) Indian nationals were caught within the Complex trying to

walk out with expensive goods by tendering receipts of purchase with falsely paid endorsements on them. Investigations revealed that touts possessing forged paid stamps were accosting Indians in the Complex, getting purchase receipts written by salesmen by-passing the cashiers counter, and making false 'Paid' stamps on the receipts.

- (3) Attempts by Indian nationals to leave the country through a port but not having with them their duty free purchases. When a penalty was imposed on these persons they did not have money to pay a fine.
- (4) Detention of Indians who were trying to bring in bullion or Indian goods for sale here in addition to their official foreign exchange.

These Indians however, brought no further benefits to the economy unlike other tourists. Apart from their payment for the duty free goods they spent very little. Most of them existed on the cheapest meals, transport and accommodation and on an average US\$ 7 per day unlike other tourists from the region whose expenses averaged around US\$ 50 per day.

According to reports in the Indian press, in 1983, up to June about 800 passengers passed through Madras airport daily to purchase at the DFSC in Colombo. One of the most popular items they carried was Video Cassette recorders averaging about 100 per day. Indian school children, particularly girls in the age group of 9-16 years were also big customers at the DFSC, and they carried away cosmetics and dolls; while the boys purchased wristwatches and cameras. Other Indian nationals showed greater interest in the wide range of electrical goods available.

Following the restrictions introduced by the Indian government and later the ethnic disturbances in Colombo the number of Asian tourists came down from an average of about 31,000 a month up to May 1983 to about 3,000 in September 1983. The number of foreigners entering the complex also fell drastically from around 20,000 a month in early 1983 to around 3,000 per month in 1984; while turnover in more than 50 percent of the shops at the DFSC fell by over 60 percent. A major slice of Colombo's DFSC business was taken away with the fall in numbers of Indian shoppers.

Shipping Lines, a subsidiary of the Ceylon Shipping Corporation which comes under the Ministry of Food and Shipping. The Management of the DFSC from its inception was in the hands of this Company.

The rent charged at the new premises is comparatively high, as seen in the table below:

Rent per Sq. Metre

	Old Premises (Approx)	New Premises
Ground Floor	Rs 753.00	Rs 1,300.00
1st Floor	Rs 550.00	Rs 975.00
2nd Floor	Rs 403.00	Rs 875.00
3rd Floor	Rs 387.00	Rs 875.00
4th Floor	Rs 387.00	

The rent charged at the new premises is almost twice the rent charged at the earlier location. The cost of electricity at the Complex is also divided among the shoppers according to the floor area of their shops.

Security services are provided by Police and Customs, while a private security firm also provides guards at the gate and the Ceylon Shipping Lines has appointed a Liaison Officer and other staff who recover the entrance fees and attend to other administrative functions of the Complex.

### The Wider Issues

Shop owners in the Duty Free Shopping Complex were asked for their suggestions on how operations in the Complex could be made more effective. The suggestions emanating from almost everyone of them were that 'over the counter' deliveries and the earlier rebonding facilities be restored. However, the authorities maintained that from past experience it was difficult to keep down malpractices without these restrictions and also that these malpractices had taken place with the assistance or connivance of duty free traders or their employees. One of the objectives in setting up of the DFSC Complex in 1981 was to divert to Sri Lanka foreign exchange that would otherwise have been spent in other countries by returning expatriates and visiting foreign nationals. Another objective was "to give an impetus to trade" and "to be of immense service to the

country's economy by earning a rich slice of foreign exchange". It is not easy to measure in quantitative terms the extent to which these objects have been achieved upto date, but what is clear is that at the start a considerable amount of foreign exchange was diverted to the DFSC by returning expatriates and visiting Indian nationals. The situation, however, changed with more regulations being introduced both at the DFSC and in India. This trend in turn adversely affected the foreign exchange earnings of the Complex.

What has yet not been fully assessed is the extent to which activity of the DFSC has become part of the abuses of an essential facility of liberalised trade and how far part of DFSC business has been sucked into the activity of the 'underground economy'. Within an 'underground' or 'black' economy incomes earned are not reported to either tax authorities or reflected in the country's national accounts. Such 'unofficial or parallel' economic activity results in a flouting of exchange control regulations and a high degree of tax evasion, which in turn reduces the value of available tax incentives, distorts the entire economic planning process and does serious damage to the economy. There is no doubt however that activities of an 'underground' economy tend to grow with greater regulation of the economy, high levels of taxation and bureaucratic and other avenues of corruption. In Sri Lanka's case while the economy was liberalised it was necessary to maintain a degree of control or regulation. The result is that unscrupulous businessmen have made every attempt to get around the regulations.

In this process activities that are hard to officially control have come into existence and invalidated the very objectives for which the regulations were introduced. For instance, a certain degree of regulation by the financial authorities is necessary for stability in financial markets and therefore controls are brought in on interest rates and credit disbursements. Such controls have given rise to a Black market' for money, sometimes called the 'curb market' where the

interest received by lenders is far greater than on the official rates and these earnings are generally not reported to tax authorities. This is also happening in foreign exchange markets where regulation has been necessary. Here, as a result of distortion in exchange rates and controls the over invoicing of imports and under invoicing of exports and unofficial dealing in foreign exchange has become highly profitable. Even worse is the illegal trafficking or smuggling of gold, gems and foreign currency all of which help the smuggler to amass foreign exchange abroad, which is a means for some individuals to transfer their assets out of the country and also provides foreign exchange to be sold at a 'price' in the 'black market' domestically. Here too a 'black market' exists for currency parallel with the official market, and furthermore large untaxed incomes are created. This situation is worsened, and such illegal transactions thrive, in a situation where persons in public service find themselves in control of powers that can be used to generate private gains. The private use of public power is obviously improper and illegal but, has unfortunately today become a fact of life in many of those countries which have been compelled to maintain a degree of regulation and controls in their economies.

Liberalisation of the economy while meant to minimise and even eliminate many of these ills has also opened more opportunities to smugglers and similar parasitic elements. Thus, when unscrupulous businessmen find that there is more to gain in their 'underground' activity the broader issues arise as to how far controls should be introduced or liberalised facilities made available. Considering the regular reports that appear in the press of organised smuggling activity ( a sampling a recorded in the Diary of Events on page 2) and the unfortunate incidents and adverse publicity, that have marred the history of the DFSC the issue needs to be faced how far the gains from the DFSC and liberalised trade of which it is a part could more profitably benefit Sri Lanka's economy.

(This Special Report is from a study by W.G.S. Waldyanatha of the Bank's Research Department).