Import Licensing in Pakistan

by

SYED NAWAB HAIDER NAQVI*

INTRODUCTION

Pakistan's import trade in the private sector is regulated by an elaborate licensing system. It is complex in its structure and detailed in its operation. The structural complexity of the system arises from the simultaneous operation of different types of licences which seek to regulate the import sector in microscopic detail. It regulates the volume of imports, the composition of imports, and, in certain cases, even the sources of imports.

This elaborate system is administered by the Chief Controller of Imports and Exports (CCI&E), in the Ministry of Commerce, who is the principal licensing authority in the country. His task is to assess import needs and then to allocate scarce foreign-exchange resources earmarked for the private sector. In arriving at his decisions he is guided, on the one hand, by the latest market intelligence reports regarding the price trends of imported commodities as the indicators of what the market actually needs, and on the other hand, by official views of what the market should need, and in what proportion, to conform to the broader scheme of ensuring an optimal allocation of domestic resources. The formulation of the semi-annual Import Policy, which is the sum-total of all these varied and complex decisions, is, therefore, a momentous undertaking, and occupies a central position in the broader strategy of economic planning.

It is the purpose of this study to present an analytical description of the working of the licensing system in Pakistan, and to raise questions concerning the implications of the system for resource allocation in the country. The study is divided into six sections. While the first section is introductory, in the second

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* The author is a Research Economist in the Institute of Development Economics. He wishes to acknowledge his indebtedness to Dr. Philip S. Thomas, a Research Adviser at the Institute for helping him throughout the preparation of this paper. He also wishes to thank Dr. Mark W. Leiserson, Dr. Stephen R. Lewis, Dr. Eric Gustafson who are Joint Director and Research Advisers, respectively in the Institute, for offering helpful comments. Because of the lack of published information about the import licensing system, numerous conversations were required with persons in the import business and in government. While individual acknowledgement is not possible, the assistance received is most appreciated. The only published source used are the successive issues of *Pakistan Trade* for the years 1947-63 published by the Department of Trade Promotion, Ministry of Commerce, Government of Pakistan for the three basic documents of the government: the Import Policy, the Explanatory Statements of Commerce Minister on the Import Policy and the Basis of Licensing. Special thanks are due to Mr. Afazuddin Ahmed, Assistant Controller of Imports and Exports, with whom the author had several long discussions about the mechanics of the system. However, the author assumes full responsibility for the views expressed in this paper and for any errors that still remain.

we describe the overall administrative framework within which the licensing system operates. In the third section are discussed the main objectives of the licensing system and the nature of the decision-making process involved in translating these objectives into the import policy. The next section is concerned with a description of ways in which these decisions are implemented. In the fifth section, we focus our attention on the implications of a particular import policy on the allocation of domestic resources. The concluding section raises certain questions about the operation of the system which are important for policy decisions.

II

The licensing system in Pakistan is closely linked with the exchange-control system which regulates both the inflow and outflow of foreign-exchange. On the one hand, exporters are required to surrender their entire foreign-exchange earnings to the State Bank of Pakistan. The foreign-exchange expenditure on imports, on the other hand, is regulated by a high-level Foreign Exchange Committee, which is charged with preparing the annual Foreign Exchange Budget, and acting as watchdog on the foreign-exchange position of the country throughout the year[1].

The Foreign Exchange Budget, a secret document, is an uptodate, comprehensive record of the foreign-exchange position of the country. It includes a review of the past and an estimate for the future, on the receipts as well as on the expenditures side. Foreign-exchange expenditure in the budget period is limited by the expected accruals of foreign exchange during the year plus the extent, decided by the Committee, to which the foreign-exchange reserves are to be drawn down. A part of foreign exchange (about one-fifteenth) is automatically designated for imports in the private sector made under the Export Bonus Scheme (to be discussed below)[2]. The remaining foreign-exchange expenditure is divided, in ratios determined by the Committee every year, between the public and private sectors[3]. (The proportion in recent years has been about one-third public and two-thirds private). The foreign-exchange allocation to the public sector is distributed among the various ministries by the Committee,

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[1] The Committee is composed of seven members, with the Finance Secretary acting as Chairman. The other members are Secretaries of the Ministries of Commerce, Industries, Agriculture, Defence, Foreign Affairs, and a representative of the Planning Commission, A representative of the State Bank is a consultant to the Committee.

[2] For a detailed analysis of this Scheme, *see*, Henry J. Bruton and Swadesh R. Bose, *The Pakistan Export Bonus Scheme*. (Karachi: Institute of Development Economics, April 1963).

[3] Separate allocations are made for the public and the so-called semi-public sector, the latter including institutions like the Pakistan Industrial Development Corporation (PIDC), the Pakistan Industrial Credit and Investment Corporation (PICIC), and the Industrial Development Bank of Pakistan (IDBP).

which further specifies how much each ministry can spend on developmental and nondevelopmental imports. These allocations are made on the basis of budgets presented to the Committee by the various ministries, with high priority being given to on-going projects.

The allocation to the private sector is made on the basis of the estimates of private-sector needs presented to the Committee by the Ministry of Commerce. The Foreign Exchange Committee is, however, empowered to scale down these estimates if it thinks that these claims cannot be fully accommodated in view of the foreign-exchange position of the country. The Committee, however, does not further specify, as it does in the case of public-sector imports, how much of this allocation can be spent on developmental and nondevelopmental imports. This is left to the discretion of the CCI&E.

The Foreign Exchange Budget is approved by the Cabinet after which the budgeted foreign-exchange expenditure cannot be exceeded without its prior approval. Although these allocations are tentatively made on yearly basis, utilization of these allocations (both in the public and the private sectors) is authorized, again by the Foreign Exchange Committee, for only one six-month shipping period at a time. (The two shipping periods are January-June and July-December).

The actual disbursement of foreign exchange is done through the Exchange Control Department of the State Bank of Pakistan which maintains three separate foreign-exchange accounts. Account No. 1 is credited with 20 per cent to 40 per cent (depending on the permissible rate of bonus) of exchange earnings from the export of commodities included under the Export Bonus Scheme. The balance of foreign-exchange earnings is then credited to Account No. 2, for government imports and other payments, and to Foreign Exchange Account No. 3 for private imports and other payments, in ratios determined by the Foreign Exchange Committee. Although marginal adjustments between Accounts No. 2 and No. 3 may be made by the Committee, no such adjustment is allowed to take place between Account No. 1 and the other two accounts.

After the Foreign Exchange Committee has completed its work, the CCI&E prepares the semi-annual Import Policy which is announced by the Commerce Minister on the eve of each shipping period. The Import Policy includes a general survey of the import position and presents a comprehensive list of the goods to be imported. (The detailed decision-making underlying this policy will be explained below).

It is the major responsibility of the CCI&E to issue licences to private importers against foreign-exchange accruals to Account No. 3. This is called "cash licensing". In addition, the CCI&E issues foreign-aid licences, called aid "sub-authorizations" against the Public Authorizations (PAs) issued by the Economic Affairs Division, President's Secretariat. Bonus licences are also granted by the CCI&E on the basis of import bonus-vouchers issued by the State Bank against accruals to Account No. 1.

The above discussion indicates the limits of the jurisdiction of the Chief Controller of Imports and Exports and highlights his central task, namely, the achievement of an optimal distribution of the foreign-exchange resources, including foreign aid, committed to private-sector imports by the Foreign Exchange Committee and the Ministry of Economic Affairs.

III

As noted above, the CCI&E has extensive responsibility and authority in the area of private-sector imports. He decides: *i*) what particular commodities to import (and what not to import); *ii*) how much of these commodities to import; and *iii*) who should import. Then, in view of the budget constraints, he has to grade imports in order of 'essentiality'. He decides among the competing claims for consumer, intermediate, and capital goods; and within each of these categories, he makes detailed decisions about the importance of many particular goods, keeping in mind official views about national priorities. Furthermore, he ensures that the importers who get import licences are genuine; and that each genuine importer gets an import licence, according to his financial capacity. Thus, he has to make decisions not only commodity-wise but also importer-wise. The complexity of his task is increased by the fact that all these decisions have to be made afresh (or at least reviewed) for each shipping period.

The CCI&E, therefore, constitutes a vital link between the market and the official hierarchy. His decisions complement "market decisions" in some respects and substitute for them in others. The purpose of this section is to indicate the broad outlines of the decision-making process, to note the major objectives which guide the CCI&E, and to spell out in general terms the procedure by which the basic decisions are made.

There are at least four major objectives which guide the Chief Controller of Imports and Exports in making his decisions: *i*) to keep the prices of essential consumer goods, like drugs and medicines, within the reach of the common man by allowing relatively liberal imports of such goods (and conversely curtailing luxury imports); *ii*) to ensure the fullest possible utilization of the existing installed industrial capacity of each industrial unit, and an "orderly" creation of new capacity, consistent with the plan objective of an optimal allocation of domestic resources; *iii*) to stimulate exports; and, finally *iv*) to attain a better regional distribution of imported goods[4].

Guided by these objectives, the CCI&E sets about the task of allocating foreign exchange to the private sector. In deciding which commodities are to be imported, the Chief Controller is guided by the decisions of the Central Ceilings Committee in the Ministry of Commerce, of which the Secretary, Ministry of Commerce, is the Chairman, and the Chief Controller of Imports and Exports is a member[5]. It is the job of this Committee, *inter alia*, to specify the commodities which are to be included or excluded from the import list in each shipping period.

The decisions of the Chief Controller are also influenced by the recommendations of the Import Advisory Council, in the Ministry of Commerce, chaired by the Commerce Secretary and on which the CCI&E also sits. This committee includes as members representatives from Chambers of Commerce and Industry. The broad-based membership of the committee (numbering about 50) enables the Chief Controller to have a cross-section of official and nonofficial opinion on the advisability of making marginal changes in the import list, and tends to reduce the element of arbitrariness in such decisions.

The Chief Controller has also to decide on the commodities which should be taken off the import list permanently, *i.e.*, "banned", if the country becomes "self-sufficient" in such commodities. In doing this, he is guided mainly by the recommendations of Tariff Commission. These recommendations are generally accepted by the CCI&E, but he can reject them, and he can even ban imports of certain items without the recommendation of the Tariff Commission, if in his judgement ample supplies of import substitutes are domestically available.

The task of assessing the needs of industries is entrusted to the Directorates of Industries of East Pakistan and West Pakistan. If machinery is to be imported for the creation of new industrial capacity, the CCI&E seeks the advice of these Directorates of Industries, who, in turn, are guided by the general investment policy of the Central Permissions Committee in the Ministry of Industries (whose responsibility it is to sanction new investment and determine its composi-

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[4] Another oft-mentioned objective of licensing policy is the "conservation of foreign exchange". However, in the light of our previous discussion, it is clear that the Chief Controller's job is only to allocate the foreign exchange earmarked for private-sector imports by the Foreign Exchange Committee. (This is not to deny that the Chief Controller's estimates of private-sector requirements influence the opinion of the Foreign Exchange Committee.)

[5] The Committee consists of 15 members: the Commerce Secretary (Chairman); the Chief Controller; the Controllers of Lahore and Chittagong; the Deputy Controller Incharge, Karachi; the Secretary of Commerce, Labour and Industry, E. Pakistan; Directors of Industries for East and West Pakistan; and representatives from the various ministries of the Central Government.

tion in every year). The investment policy of the Central Permissions Committee is influenced by the allocation for new investment made in the Industrial Investment Schedule, prepared by the Ministry of Industries. This Schedule sets ceilings on new investment and investment for balancing and modernization. Thus, in deciding on the imports of machinery required for setting up new industries, the Chief Controller has little independent discretion, for no new capacity can be created without the approval of the Central Permissions Committee.

In deciding how much of each commodity is to be imported during a given shipping period, the Chief Controller assesses market "requirements" of the included commodities by observing price movements. If the price of a certain commodity has risen considerably in the previous shipping period, it is taken as an indication that this good is in 'short supply'. Imports of such commodities are liberalized within the limits of foreign-exchange availabilities. There is a Price Check Unit within the CCI&E's office to keep a record of changes in the prices of imported commodities. Also, the Chief Controller, regularly entertains representations from the importers of the included commodities and takes their views into account in allocating foreign exchange to various items. But again, the CCI&E reserves the right to reject or accept such applications. In the case of making changes in imports of machinery, raw materials, and spare parts, the Chief Controller, in practice, accepts the assessment of each importer's needs made by the provincial Directorates of Industries. In cases where the Tariff Commission recommend "partial protection" to certain industries, the Chief Controller takes their opinion into account in reducing the imports of such items. In this way, the Controller is in a position to combine in a certain fashion the market decisions (conveyed to him by the Price Check Units) and the official decisions of the Provincial Directorates of Industries and the Tariff Commission.

In addition to these decisions, the Chief Controller has also to decide who should import the commodities included in the import list. He has full powers to include or exclude any person from the list of "eligible" importers. The manner in which the eligibility of importers is determined is explained below in connection with the description of commercial and industrial licensing-procedures.

IV

In addition to deciding what to import, how much to import and who is to import, the Chief Controller has the task of *i*) allocating each of the imports on the import list to each eligible importer, and *ii*) to fix the monetary limit for both. (The monetary limit for each commodity is fixed to prevent excess imports of certain commodities, to keep the relative price structure in a desirable relationship, and to satisfy the relative needs for consumption and investment; the limit for each importer is set to prevent an undesired degree of concentration of import trade in a few hands). The Chief Controller has also to ensure that the import trade does not become the monopoly of a few regions. Again, all this has to be done for all importers in every shipping period.

For the sake of administrative convenience, total private-sector imports are broadly divided between 'industrial' and 'commercial' imports. The former consist of machinery, spare parts, and raw materials, imported by 'industrial importers" for their own use. The common characteristic of 'commercial' imports is that they are resold by the 'commercial importer', who is a middleman and not a final user. While the bulk of commercial imports are consumer goods, raw materials are also imported for resale.

In implementing final licensing decisions, the CCI&E is assisted by three principal government agencies: *i*) Provincial Directorates of Industries *ii*) the Central Ceilings Committee; and *iii*) three regional Licensing Boards. (Both *ii*) and *iii*) are under the Ministry of Commerce). The allocation of industrial licences, to be explained below, is based essentially on the assessments made by the Provincial Directorates of Industries. The Central Ceilings Committee, besides participating in the decisions as to which goods should be imported, also helps the CCI&E in allocating the foreign exchange available for private-sector imports between industrial and commercial imports, among the various commodities as well as the various regions. It is then the task of the three regional Licensing Boards, located in Karachi, Lahore, and Chittagong, to determine the size of the licence (for every specified commodity) to be granted to each of the eligible importers located in their respective regions[6]. Each board consolidates its decisions in a "Basis of Licensing", which is published within a few days of the announcement of the Import Policy. The issuance of licences to importers, both industrial and commercial, is done after the publication of these Bases of Licensing.

Commercial Licensing

Once these Bases of Licensing are announced, the CCI&E and the regional controllers have the task of issuing licences to eligible commercial importers in each region in each shipping period. The difficult task, involved in singling out the "eligible importers" from a large number of potential importers, has entailed

[6] The Karachi Licensing Board has four members: the Chief Controller of Imports and Exports (Chairman), and representatives of Central Ministries of Industries and Finance and the Director of Industries, West Pakistan. The Lahore and Chittagong Licensing Boards also have four members each, with the regional Controllers of Imports and Exports as their Chairmen. Other members are representatives of the Provincial Ministries of Finance, Commerce and Industries.

the adoption of "a rule of thumb", which defines eligible importers as those who had an import performance to their credit during the period July 1950-November 1952, when there was essentially free importing under the Open General Licence (O.G.L.) system.

Under this O.G.L. system, any importer from any part of the country could import any amount of the commodities put on the so-called "O.G.L. XIII" list. By this notification, the CCI&E announced the commodities that could be imported in a particular shipping period. Importers could then open a letter of credit with their banks and order shipment of the goods. When the Korean-War boom ended, Pakistan's export earnings fell rapidly; and the O.G.L. system was suspended in November 1952. The Chief Controller impounded all licences issued in the preceding shipping period (July-December 1952) and reissued them under the "category system" which remains the core of commercial licensing today.

Under the category system, introduced in January 1953, each importer of the O.G.L. period was given a monetary "category" for each type of goods that he imported. The monetary value of each category was determined by average imports during the five O.G.L. shipping periods between July 1950 and December 1952. A category is not a definite commitment by the government to issue to the importer a licence of equivalent value, but rather it is in the nature of a standardized unit of account; the actual value of each licence, specified in the Basis of Licensing, is expressed as a certain percentage of the monetary value of each category. The variation in this percentage is the main instrument by which the CCI&E enforces a liberal or a stringent Import Policy.

A category signifies that its holder is considered an eligible importer. Each "category holder" is entitled to only one regular licence for one specified commodity in a shipping period. (One importer, however, can hold more than one category if he imported several types of goods during the O.G.L. base-period).

It will be noted that the category system enables the CCI&E to determine simultaneously the commodities to be imported and the importers eligible to receive licences. It enables him to start the issuance of licences within a few days after the announcement of the Bases of Licensing. It was, however, felt that the category system tended to be overtly rigid with respect to both the commodities that could be imported and also the number of eligible importers in a given shipping period. To remedy these shortcomings of the system, two new types of licences have been introduced: automatic licences (also called "repeat" licences); and a new type of Open General Licence.

Automatic Licensing

The automatic licensing system is essentially an extension of the category system in that it enables the category holders to get more than one licence in one shipping period for the import of those items on regular licensing which are also on the automatic list. Under this system an importer becomes entitled to another licence (a repeat licence) as soon as he has utilized the first licence (the initial licence). Repeat licences are issued at 100 per cent of the value of the initial licence. So long as the total foreign-exchange allocation is not exceeded, there is no limit to the number of repeat licences that an importer can get during one shipping period. It depends on how soon he utilizes them. As a proof of utilization, the commercial importer has to furnish a bill of lading of a value equal to at least 75 per cent of the previous licence[7]. Category holders can receive automatic licences only for such commodities in respect of which they hold a category and only up to the value they are allowed under regular licensing. For instance, if a category holder is granted a regular licence of a value which is, say, 75 per cent of his category, he can apply for an automatic licence of that amount.

The Chief Controller of Imports and Exports announces a list of commodities allowed to be imported under the automatic licensing system at the time of announcing the Import Policy[8]. He also fixes the maximum and minimum limits on the value of permissible imports of each of the included commodities. As under the category system, one licence is valid for only one commodity. However, one person can get more than one licence; in fact, as many automatic licences as he has categories, provided all of these items are also on the automatic list.

The purpose of automatic licensing was to introduce flexibility into the rigid category system by allowing category holders to get more than one licence in one shipping period for those items which are on both the regular as well as the automatic list. The automatic system encourages a speedy utilization of licences and discourages speculative stock accumulation, since an importer can

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[7] Previously, a bill of entry was required. However, the policy has been to reduce the items for which the bill-of-entry requirement holds. When the scheme was started in 1961, a bill of entry was required as a proof of utilization for all the commodities allowed to be imported under the scheme. Furthermore, in order to discourage any speculative stock accumulation, before issuance of any licence importers are required to submit a declaration that stocks held by them or by their banks on their behalf have been liquidated. This restriction applies to all types of licences.

[8] The list of items put on automatic licensing is published as an annexure to the Import Policy.

get another licence as soon as the existing one is utilized and the stocks sold[9].

Open General Licence (O.G.L.)

Perhaps the most heralded component of the commercial licensing system is the reintroduction of a new "O.G.L." system in 1961. The purpose of the new O.G.L. is to allow new importers to have access to foreign exchange, and especially, to encourage new importers from regions of the country where there were no (or few) importers during the 1950-52 base-period.

The present O.G.L., however, is much more restricted than the old O.G.L. system. In order to encourage new importers, no industrial-licence holder can apply for a new O.G.L. licence; and similarly, there is a prohibition against all commercial licencees with categories in excess of Rs. 1,000 during the July-December 1960 shipping period. Furthermore, a wider regional distribution of licences is promoted by excluding importers located in Karachi, Lahore, Dacca, Narayanganj and Chittagong from the list of those eligible to receive an O.G.L. licence. In addition, the Chief Controller fixes, in each shipping period, the items that can be imported against the O.G.L. and the monetary limit for each licence[10]. Moreover, any existing or future restrictions placed on the import of any item automatically apply to licences issued under the O.G.L. system. For example, certain items can be imported only for East Pakistan.

Within these limitations, which appear sizeable, anybody interested in importing an item placed under the O.G.L. should be able to get a licence for any item listed. The importer, however, has to get himself registered, for which he must fulfill several formalities. The applicant has to apply on a prescribed form and must submit his application by a certain deadline, which is generally the end of February and July for the first and second shipping period respectively. However, once he is registered as an eligible importer, all he has to do thereafter is to open a letter of credit with his bank. His bank arranges the

[9] It is claimed for the system that it tends to lower the prices of the goods imported under the scheme, by liberalizing imports and by promoting greater competition and efficiency in the import trade. However, contrary to the popular notion, the advantages arising out of the greater efficiency in the import trade may not be passed on to the consumer. For, given the amount of foreign exchange allocated to imports, the inclusion of new firms will reduce the quotas of others, but, as the supply of imports remains the same, the prices of imported goods may not fall. The entry of new importers will, however, reduce the profits of the established importers. If more foreign exchange is allocated to an item when it is placed on automatic licensing, as is often the case, then the resulting fall in prices, if any, will be due to greater imports and not to automatic licensing *per se*. The same results could be approximated under any system of licensing simply by allocating a greater amount of foreign exchange to private imports. Prices may, however, fall under the system as the importer will now have less incentive to carry large stocks as he can get another licence as soon as the previous licence is utilized. With any given amount of imports, a decline in the inventory-sales ratio would increase the effective supply and tend somewhat to lower prices.

[10] The O.G.L. list is published as an annexure to the Import Policy.

necessary licence for him (it is claimed) in 24 hours. Each O.G.L. importer is eligible for only one licence but repeat facilities are available (as under automatic licensing). The O.G.L. licences are for one shipping period only, at the end of which the importer must reapply if he wants a licence for the following period.

The scope of the new O.G.L. has been gradually enlarged by increasing the number of items allowed under this type of licence and by raising the minimum units admissible for various items. The O.G.L. list now consists of a variety of items, like iron and steel, tractors and tractor spares, spare parts for automatic vehicles, tyres and tubes, drugs and medicines, and books. It was claimed by the Commerce Minister that as a result of the introduction of the O.G.L. 'the newcomers outnumber the category-holder'[11]. This statement should not, however, be taken to mean that the total amount of foreign exchange licensed under the O.G.L. is larger than that licensed under regular licensing; exactly, the opposite is true. Over 90 per cent of commercial licensing is still done within the category system. However, a net addition has been made to the ranks of importers, and wider regional distribution of import licences has probably been achieved.

Industrial Licensing

In implementing his decisions regarding industrial licensing, the CCI&E is faced with a more complicated problem than in commercial licensing. As in commercial licensing, he has to allocate foreign exchange to each industrial goods and to each industrial importer in every shipping period. In addition, he makes foreign exchange available separately for the "current requirements" of the existing installed capacity and for the creation of new capacity. He also makes a distinction between industries producing mainly for home production and those producing for exports.

In tackling the first problem, the CCI&E has relied on the Provincial Directorates of Industries. The Directorates have evolved a "quota system" to routinize the issue of licences to industrial importers for the import of raw materials and spare parts. Under this system, each eligible industrial importer, called the "quota-holder", is assigned a quota signifying that its holder is an eligible importer and specifying his "requirements" for industrial raw materials and spare parts for one shipping period. This enables the Provincial Directorates to determine simultaneously the commodities (*i.e.*, spare parts and raw materials) which should be imported, and the industrial importers who are eligible to import them in each shipping period.

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11 *See*, Commerce Minister's Explanatory Statement on the Import Policy for July-December, 1962, *Pakistan Trade*, February 1963.

Most of existing quotas were created on the basis of survey of industrial units, started in 1955/56. It was provided that similar industrial surveys would be regularly undertaken by the Provincial Directorates of Industries so that new quotas could be created. (It will be noted that unlike categories which have not been increased, the creation of quotas is a continuing process). The Provincial Directorates specify the percentage of his quota that each quota-holder will be allowed in each shipping period. Having done this, the Directorates issue to each quota-holder an "assessment certificate" which indicates his 'requirements' for raw materials and spare parts to operate on a single-shift basis. The CCI&E then issues industrial licences called 'regular industrial licences' largely on the basis of these assessment certificates.

The CCI&E also issues licences for importing machinery for new industrial capacity in the country. However, as pointed out earlier, the Central Permissions Committee, in the Ministry of Industries, is mainly responsible for sanctioning the creation of new capacity and the balancing and modernization of the existing industries in the private sector. Accordingly, applications for new industries are received by the Central Permissions Committee. Upon their approval, applicants become entitled to industrial licences which are automatically issued by the CCI&E. Furthermore, a person intending to establish a new industry, or planning to add to an existing one, also becomes entitled to an industrial licence, if his loan application to the Pakistan Industrial Credit and Investment Corporation or to the Pakistan Industrial Development Bank is accepted. The acceptance of a loan application implies the approval of the Central Ceilings Committee, and similarly, results in the automatic issuance of a licence by the CCI&E.

The CCI&E, thus, issues industrial licences, exercising little discretion of his own, for machinery, spare parts, and raw material in each shipping period. These licences are not interchangeable (*e.g.*, a machinery licence is valid only for the import of machinery; it cannot be used to import raw materials or spare parts). However, their actual issuance, as in the case of commercial licences, follows the announcement of the Bases of Licensing. These regular licences are issued only once in a shipping period, (However, applications for additional licences in the case of emergency replacement of machinery are always entertained.)

Licences on Request Basis

The CCI&E also issues licences on a request basis to encourage certain industries with an export performance or an export promise. For this purpose, in 1961 a survey was made of industries with an export potential or export performance, and licences were issued to eligible units within these industries.

to meet their requirements of balancing and modernization. Repeat facilities were extended to this group of industries, *i.e.*, the "request importer" can get more than one licence in one shipping period under the system. At the beginning of each shipping period, the Controller announces a list of industries put on the "Request Basis". According to the scheme, industries are divided into three subgroups: *i*) Industries which are licensed on the basis of their request for the shipping period, *ii*) Industries to which initial licences for each shipping period are given at 80 per cent of the value licences in the preceding shipping period (further licensing to this group depends on their export performance); *iii*) Industries which are licensed on the same basis on which they were licensed in the preceding period[12].

The industrial importer in the first group is required to make an assessment of his requirements of raw materials and spare parts for the ensuing twelve months (instead of the usual period of six months). Licences are issued immediately for the amounts likely to be utilized in one shipping period, and for the balance, an undertaking is given to the applicant that a licence or sub-authorization will be issued to him, subject to the availability of foreign exchange, well before the commencement of the next shipping period. In this group are included nine industries, such as sports goods, surgical instruments, tanning and carpet-making which are all established export industries. These industries form the "request group proper" and get licences on the basis of their own assessment of their needs, so long as these estimates are not too unreasonable. Generally, a request which does not exceed the industries' requirements to operate on three-shift capacity is treated as reasonable.

The licensing procedure for the request group requires the applicants to file with their applications for licences a schedule showing the dates for which confirmed irrevocable letters of credit will be established. Where the applicants do not operate on the basis of a letter of credit, they are required to indicate their programme of shipment.

Provisions have been made to ensure that the industries falling in groups *ii*) and *iii*) fulfill their export promise. The general procedure is to require proof of the utilization of the previous licence[13]. Subsequent licences are then issued at 100 per cent of *f.o.b.* value of exports. Those, who fail to fulfill their export undertakings, have to surrender an equivalent amount of foreign exchange in bonus vouchers. (These restrictions do not apply to the first group of industries.)

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[12] Three separate lists of such industries are published as an annexure to the Import Policy.

[13] Utilization in this context means opening of irrevocable letter of credit for 100 per cent of the value of the shipment, or at least 75 per cent of the value of earlier licences.

It may be noted that the scheme seeks to remove supply bottlenecks in respect of import requirements of only those small export-industries which are established exporters, and not of any of those which may have an export promise.

Import Bonus-Vouchers

In addition to the commercial and industrial licences, a part of the private-sector imports are made against import bonus-vouchers, issued under the Export Bonus Scheme, introduced in 1959 as an additional incentive to exporters. Under the scheme, exporters are allowed to retain a specified part (usually between 20 per cent to 40 per cent) of their foreign-exchange earnings (called the bonus) in the form of "import bonus-vouchers". The State Bank of Pakistan is committed to issue bonus vouchers equal in value to accruals to Account No. 1 in a given shipping period[14]. Bonus-vouchers are marketable and command a positive premium in the market. On the basis of these vouchers, the CCI&E is obliged to issue "bonus licences". The bonus importer is free to import any item, whether industrial or commercial, on the bonus list announced by the Chief Controller with the Import Policy.

Import bonus-vouchers (and the bonus licences) are issued against Account No. 1, and hence formally fall outside the pale of the regular licensing system. Nevertheless, the Chief Controller regulates the effectiveness of the system in many important ways. First, as pointed out above, the import bonus-list is drawn up by the CCI&E, and he has the powers to expand or curtail it. More fundamentally, the CCI&E also prescribes in every shipping period the rate of bonus which each exporter is allowed. He also has the power to include or exclude any exporter in the list of covered industries. Thus, although falling outside the scope of the regular licensing system, the bonus-vouchers should be considered as a significant supplement to it.

It is important to note that the system of import bonus-vouchers is based on principles entirely different from those on which the licensing system is based. Another important difference between the two systems is that whereas the licences issued under the latter system are granted at the official rate of exchange, those issued under the former can be bought only at the market rate (*i.e.*, at a positive premium), which due to the excess demand for imports is substantially higher than the official rate[15].

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[14] *See*, page 53.

[15] It must, however, be pointed out that the rate of premium on bonus-vouchers sold in the market does not measure the extent to which the rupee is overvalued. This would be so if all imports were made against bonus-vouchers. It is, however, a rough indicator.

V

We have now before us a picture of the scope, structure, mechanics, and rationale of the licensing system. We must, however, take into account the direct and indirect effects that licensing policy may have on resource allocation. In our present study, we cannot say anything definitive about the actual effects that licensing policy has had. But it is important to note that there does exist a crucial relationship between licensing policy and the pattern of domestic resource allocation.

Because of extensive controls over the import of capital, intermediate, and consumption goods in the private sector, the government influence directly the levels and composition of consumption and investment in the economy and can also influence the pattern of investment by allocating larger or smaller amounts to particular types of industrial imports. The ultimate impact of these direct control measures, however, cannot be assessed without taking into account the fact that the licensing system has very important indirect effects on the investment choices between consumer-goods and capital-goods industries. The decision whether to import spare parts or raw materials or to produce them in Pakistan is influenced by the allocation of import quotas for the items themselves. These indirect effects flow from the protective aspects of the licensing system. Protection affects the relative profitabilities of undertaking various production activities and/or the per cent of capacity at which existing facilities are utilized. If smaller amounts of luxury consumer-goods imports were licensed, the resulting high prices of such goods would increase the profitability of new investment in the luxury-goods industries. On the other hand, if capital goods, spare parts and raw materials were liberally licensed, the lower prices of these goods would mean lower profitability and less domestic investment for the production of such goods.

In addition to its effect on the relative profitability of investment in different industries, the licensing system also influences both directly and indirectly the basic investment choice between producing for the domestic market and for exports. The system of request licences, covering industries with an export "performance" and prescribing penalties for those who do not fulfill their promise, helps and encourages the covered industries. In addition, the Export Bonus Scheme is a direct financial incentive to industries with an export promise. These direct effects are export-promoting.

The indirect effects of licensing, however, strongly favour production for the domestic market. The regular licensing system not only has different indirect effects on various industries producing for the domestic market (as noted above), but, in general, the restriction on imports encourages production for the protected domestic market relative to exports. While these effects are generally recognized, it is seldom realized that the Export Bonus Scheme also has important protective effects. Whereas the rate of bonus determines the incentive to export, the height of the premium, besides being a determinant of the magnitude of the export incentive, is also a measure of the degree of protection provided to import substitution, actual and potential, of the goods imported under the scheme. Thus, by manipulating the rate of bonus and influencing the rate of premium, the licensing authorities affect the relative profitability of producing for exports or for domestic use. A high rate of bonus accompanied by a relatively low level of premium will provide a greater relative incentive to exports than to import substitution, compared with a high-level premium combined with a low rate of bonus. Thus, while a higher premium directly encourages exports, it gives a relatively larger indirect encouragement to import substitution[16].

VI

The preceding sections have presented: the place of the licensing system in the broader setting of exchange controls; the objectives of the system and the fundamental decision-making required to give these objectives a practical shape; the mechanics of the system, indicating the mode of its implementation; and finally, the implications that licensing policy may have for resource allocation. Because this study has been essentially a detailed description of the licensing system, no summary will be attempted. Rather, this final section will stress certain aspects of licensing requiring further research.

One basic question concerns the administrative efficiency of the licensing system: How well is it performing the job for which it was designed? Do the various authorities involved have adequate staffs and sufficient basic information to perform their tasks effectively and to achieve their desired objectives? From our description, it is clear that many agencies, officers, and committees, both central and provincial, are involved. How well are these groups coordinated?

Another question relates to the actual impact of the licensing system on the composition of imports and the allocation of resources. Commercial and industrial licensing cover only a part of total imports. How large is this part relative to other imports—public sector, semi-public, bonus-voucher, project

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[16] For a more rigorous demonstration of this point, *See*, S. N. H. Naqvi, "The Balance-of-Payments Problem and Resource Allocation in Pakistan—A Linear Programming Approach", *Pakistan Development Review*, Vol. III, No. 3, Autumn 1963.

aid, and commodity aid? What have been the past trends in imports of consumer, intermediate, and capital goods? Which industries have been encouraged by the direct and indirect effects of the licensing system? What are the policy alternatives to the licensing system: import surcharge, licence auctioning, multiple exchange-rates, devaluation, *etc*? How will each of these policies ration foreign exchange among competing uses?

Although our descriptive study does not provide answers to these important questions, a few comments on the effectiveness of the licensing system may be in order, based on certain general characteristics of the system itself. There is a general realization in the government that the licensing system's reliance on rigid categories and quotas has undesirable effects. It is rigid both with respect to the number of the commodities that can be imported and the number of importers who can import them. A major part of the total import trade is concentrated in the hands of the category- and the quota-holders, and "monopoly" or "unearned" profits accrue to them due to the excess demand for imports at the current rate of exchange. Accordingly, the government has taken various steps, noted above, to introduce greater flexibility and competitiveness into the system.

The limited experience with the reformed licensing system has not been particularly encouraging, however. The automatic licensing system seems to have stimulated a scramble for licences and the tendency to import even in excess of current requirements; and the facility to new entrants provided by the O.G.L. has flooded the CCI&E's office with new applications much in excess of the total foreign-exchange availability. Moreover, the system of request licences provides a strong incentive to the importer to present exaggerated requests. Furthermore, there is evidence that a black market exists in import licences, which command a positive premium depending on the intensity of demand for the imported goods. The black market may become all the more active because of the government's efforts to encourage entry of smaller importers into the import business and to ensure a wider regional distribution of import licences. For, the so-called small man, particularly the one situated in up-country, finds it safer to sell his import licence to the bigger importer (the big category-holder) who knows the import business better[17].

[17] Apart from the social and moral considerations, black marketing in licences may be, to some extent, a good thing from an economic point of view. Those willing to pay a premium for the licence may well have greater need for the items to be imported than the licence-holder, or they may be able to put such items to a more efficient (or at least more profitable) use. Furthermore, a black market may tend to cancel out the inefficiency involved in the government's policy of encouraging very small importers who have to buy in small lots and who have little experience in import trade.

The result has been increased burdens on the CCI&E to ensure that repeat licensing does not simply lead to large stocks of imported goods; to check that the requests for industrial licences are not 'too unreasonable'; to make certain that export promises are fulfilled; and to take special steps to discourage black marketing in import licences, *etc*. Thus, there is reason to believe that decisions tend to be more minute under the present so-called "reformed" system than under the older category-*cum*-quota system. A vicious circle, therefore, seems to exist, in which the attempt to "liberalize" the import trade creates a situation in which it has to be regulated still more rigorously.

The basic problem is that, at the current rate of exchange, there exists an excess demand for imports. The licensing system had been introduced to ration foreign exchange in order of 'essentiality' among competing uses and the users at the fixed official rate of exchange. The category and the quota systems were devised to cope with the inevitable consequences of such a policy. In a situation where licences are riches, an attempt to relax controls may make things more difficult for the CCI&E. This reflects the fact that it is the undervaluation of foreign exchange, as much as anything in the licensing system itself, which is responsible for making the system so difficult to administer.