The Tariff Tripod of Pakistan: Protection, Export Promotion, and Revenue Generation

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This paper gives an overview of tariff structure of Pakistan. The protection of local industry, export promotion and revenue generation constitute the triangular tripod of Pakistan tariff. The said three objectives are achieved mainly through imposition of high tariffs on output goods (protection of local industry), duty- exemption schemes and SROs for exporters (export promotion), and multiple levies at import stage on tariff-inclusive price (revenue generation). About half of the revenue of FBR is collected from imports. Protection to sectors like auto and textile is high and consumer welfare is totally missing from the entire scheme of tariff. Despite high protection and multiple export promotion schemes, local manufacturing is weak and exports are stagnant. The revenue has, however, increased manifold over the years and interestingly revenue witnessed big upward jump when MFN rates of tariff fell. Revenue generation is the major consideration in tariff setting. Tariffs are set as an exercise in accounting with the assumption that rates and revenue have got a positive linear relationship. Income effect, substitution effect and volume effect hardly enter into the mental calculations of tariff setters. Due to high incidence of taxes at import stage, incentives for smuggling, under- invoicing, misdeclaration, and evasion are high. Smuggling is rampant and hard to control due to peculiar geographic situation of Pakistan. Under-invoicing is clear from the trade gap between China and Pakistan. As regards misdeclaration, evasion and corruption at ports, I calculate a hypothetical value of CD based on TWA and CEF for the period 1997-98 to 2018-19. These calculations provide interesting policy insights. First, evasion through misdeclaration is high when tariff rates are high and evasion goes down in percentage terms with reduction in tariff rates. Second, CEF increases as a result of reforms in Customs like simplification and automation of clearance processes and procedures. After detailed discussion, paper suggests that protection provided to the local industry should be time-bound with clear sunset date and accountability against rent -seeking. Based on cap-cape equation, paper further suggests that exemptions and concessions in import duties should preferably be provided through tariff code and not through SROs and difficult-to-use export-oriented schemes. In order to put the country on the trajectory of long term growth, import tariffs on input goods and machinery should be phased out in the short to medium term and instead of relying on increase in tariff rates and imposition of additional levies on imports, better policy option is to enhance CEF through reforms aimed at risk based automated clearances.

Keywords: Tariff Structure, Protection, Under-invoicing, Misdeclaration, Smuggling, Input goods, Output goods, Collection Efficiency Factor

1. INTRODUCTION

Tariffs are an important policy tool for economic growth, protection of domestic industry, revenue generation, productivity, and consumer welfare. Tariffs give price advantage to locally produced goods over imported goods of similar nature and create a wedge between domestic and world prices. The rise in domestic prices spurs domestic production of the imported goods but at the same time depresses demand due to price

effect. Thus tariffs influence production, consumption and trade. Tariffs are undeniably a reality of international trade and are used for variety of purposes by the countries but if applied excessively, they erode competitiveness of the industry by increasing cost of inputs, cause de-industrialisation by making industrial investment less viable due to eroded competitiveness, impose costs on consumers by making imported products expensive, and create anti-export bias by making domestic market more attractive than exports as local producers find a captive domestic market for their products where they have every possibility to compromise on quality and variety. Tariffs encourage trade deflection to inefficient producers through protection against competition and encourage smuggling to evade import duties.[1] The standard economic argument thus runs that tariffs create deadweight loss and distortions, and reduce welfare.

There is, however, huge divergence between theory and practice of tariffs. Almost all countries make use of tariffs for variety of reasons like import substitution, fixing balance of payments issue, revenue generation, or for retaliation.[2] Practically, tariff setting is a complex phenomenon and involves several policy trade-offs. There is trade-off between employment generation through protection to domestic industry and consumer gains through channels of less price, better quality and more variety of products. Trade-off between revenue generation and economic growth is also important at least in case of developing countries which still have heavy reliance on revenue generation through import tariffs. Moreover, the impacts of tariffs are not uniform. The benefits and costs tariffs generate differ between groups in an economy. They create both 'losers' and 'winners'. The redistributions associated with tariffs tend to generate rents which are hard to tax especially in developing countries where tax enforcement is generally weak. As tariffs provide shield to the local producers against foreign competition, so there is lobbying, pull and push and political economy factors are at play in tariff setting. Tariffs impact households as consumers, producers and wage earners etc. depending on the pass-through effect.[3] There may be substantial gains from tariff liberalisation but there is huge heterogeneity in the gains both across countries and across households within the countries (Erhan, Porto, & Rijkers, 2019).

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[1]The situation of Pakistan is bit peculiar with regard to smuggling. Pakistan shares long porous border and provides transit trade facility to Afghanistan. The goods imported under Afghanistan under Afghan Transit Trade Agreement (ATTA) are smuggled back to Pakistan. The common perception that goods do not reach Afghan border and enter Pakistani market through pilferage en route to Afghanistan may not necessarily be true as Pakistan Customs took steps like installation of trackers to ensure that goods imported under ATTA cross border but it is also undeniably a fact that goods are smuggled back due to tariff differential and porous border between the two countries. Tariff rates in Pakistan are in a sense linked to the volume of tra nsit trade. If Pakistan sets high import tariff for a commodity, the import volume of that commodity is likely to increase under Afghan transit. So not only weak anti-smuggling paraphernalia but high tariffs are also a big contributory factor to smuggling.

[2]The trade war between US and China is a case in point. There has been tit-for-tat tariff increases from both sides since over one and half year before reaching 'phase one agreement' to start de-escalating their trade war. The US wants the Chinese authorities to end currency manipulation, cease intellectual property theft and stop giving subsidies to state-owned enterprises etc. (Why the US-China Trade War could Re-escalate by Anne O.Krueger, Project Syndicate, Dec. 20,2019).

[3]The impact of tariff reduction or elimination on trading prices is called tariff pass-through or simply it means who captures the tariff rents. The full impact of tariff increase or reduction may not pass on from the border to the consumer. Imperfecti ons in the market partially isolate households from the effects of tariff. See for detailed discussion (Hayakawa, & ITO, 2015).

Tariffs are generally divided into three categories i.e. MFN, preferential, and bound tariffs. MFN tariffs normally do not discriminate among trading partners. Article 1 of GATT stipulates that no discrimination can be made under MFN principle between the trading countries and any advantage, favour, privilege, or immunity granted by any country to any other country or product of some other country shall automatically become available to other counties or same product originating in other countries. Simply put, MFN principle means 'favour one, favour all'.

Bound tariffs are specific commitments made by individual WTO member governments while negotiating entry into WTO. The bound tariff is the maximum MFN tariff level for a given commodity line which a country can apply. Bound tariffs are not necessarily the rate which WTO members apply in practice to other WTO members' products.[4] Members have the flexibility to increase or decrease their tariffs, on a non-discriminatory basis, so long as they do not raise them above their bound levels. The applied tariff is less than or may be equal to the bound tariff in practice for any particular product. The gap between the bound and applied MFN rates is called 'binding overhang'. Trade economists argue that a large binding overhang makes a country's trade policies less predictable.[5] Article XXIV of GATT, however, provides an exception to MFN principle in the form of preferential trade agreements where countries entering into PTA commit to give to partner country's products lower tariffs than MFN rate. These agreements are reciprocal and partner countries commit to reduce certain percentage from the MFN tariff,[6] but not necessarily zero tariffs. Preferences, therefore, differ between partners and the nature of agreement i.e. PTA, FTA or Customs Union.[7] In the hierarchy of these three types of tariffs, bound rates are the highest, preferential rates lowest whereas MFN tariffs lie somewhere in between bound tariff rates and preferential tariffs.

Majority of the economists support free trade and argue in favour of liberalisation but when it comes to practice, tariffs and non-tariff barriers are applied both by developing and developed countries. The old belief in mercantilism that 'exports are good and imports are bad' still persists and manifests itself in the trade policies. The mercantilist belief is evident from the very fact that tariffs are imposed on imports in particular by the developing countries whereas exports are normally not subject to tariff. The developing countries have used tariffs for multiple purposes including revenue generation, improving balance of payments, and providing protection to its industry. The consensus, however, does not exist on the salubrious effects of tariffs on local industry or otherwise. Both role and rates of tariffs are matter of much controversy among the policy makers.

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[4]Pakistan's bound tariff rates are up to 100 percent.

[5]less predictability simply means negative implications for trading and investment.

[6]For example RBD palm oil (PCT 1511.9020) has specific CD @ Rs.10800/MT while in case of import from Malaysia and Indonesia CD is chargeable @ Rs. 9180 /MT as Pakistan has entered into preferential/free trade agreements with both countries.

[7]The PTAs, FTAs and Customs unions are various forms of regional economic integration. The preferential trade arrangements provide lower barriers on trade among participating partners than on trade with non-member nations. A free trade area is a form of economic integration where all barriers are removed on trade among members but each nation retains its own barriers to trade with non-members. A customs union allows no tariffs or other barriers on trade among members and in addition to harmonising trade policies such as setting of common tariff rates towards the rest of the world. see SAFTA: Potential, Prospects and limitations (2007) by Jamil Nasir.

In 1950s and 1960s infant industry argument held sway in developing countries and tariffs were kept high to promote import substitution industrialisation (ISI). Pakistan was not an exception to the zeitgeist and used tariffs to provide protection to manufacturing sector like other countries of the region. Two sectors i.e. automotive sector and textile in particular merit mention where protection through tariff is very much visible. In auto sector, the incidence of import taxes on CBUs is as high as 250 percent and in textile it is around 60 percent for garments. The textile sector's contribution in terms of percentage share to GDP and employment is almost stagnant and in auto sector, consumer welfare is altogether missing as evident from high prices, less variety and low quality of vehicles being assembled in Pakistan.[8] As a local captive market was available to the manufacturing sector, so it was least incentivised to move to the high value chain especially in textile. The existing manufacturing sector of Pakistan can at best be characterised by low adaptation of advanced technology, low competitiveness, low value added, and low quality product segments in exports.[9] Tariff structure is sometimes an easy prey for shifting the blame for such deficiencies of industrial sector. Recently, Pakistan has come up with a 'National Tariff Policy' with objectives of simplification, strategic protection of industry, imports substitution and pro-growth tariff structure.[10]

Pakistan's export growth is almost stagnant since last many years. GDP growth is not keeping pace with the growing population. The industrial production has become less competitive with the passage of time and despite protection to several sectors of manufacturing through tariff and exemptions to their inputs from import levies, Pakistan has not been able to put itself on the trajectory of sustainable growth. The economic growth is not function of tariffs in the true sense[11] but there is need to analyse tariff structure with a view to identify tariff-related factors inhibiting growth and competitiveness. This paper is an attempt to critically study the broad contours of the existing tariff structure of Pakistan and identify areas for policy intervention to make tariff pro-growth.

The paper is structured as follows. The introductory section shall follow literature review in Section II. The broad contours of existing tariff structure shall be delineated in Section III. The next Section (Section IV) is devoted to analysis and discussion on protection, exemptions, and revenue generation functions of Pakistan's Tariff with a view to draw lessons. Section V shall give conclusion and policy options.

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[8]Pakistani automotive industry is dominated by three Japanese assemblers since last thirty years. Due to currency depreciation in the last two years, there is price increase ranging between 40 to 55 percent pointing towards lack of localisation by these assemblers. Competition from new entrants can, however, disrupt the industry as it happened in motorbike manufacturing (Cars and Competition disruption by Ali Khizar, *Business Recorder*, Feb 23, 2020).

[9]Due to high rates of protection on output goods domestic value added of many industries has historically remained very low.

[10]The National Tariff Policy 2019-24 has now formally been approved by the Cabinet. The said policy talks of principles and objectives already followed or at least said to be pursued officially but the point is whether the revenue imperative of tariff may recede in the short to medium term in view of low tax compliance, weak tax capacity to collect inland taxes and conditionality of IMF to meet revenue targets.

[11]Capital, labour and total factor productivity (TFP) are basically the ingredients of economic growth. Institutions are also considered deeper determinants of economic growth but lower tariffs are also a factor of competeness. It is in this context that WEF Global Competitiveness Report compares nations on the ladder of competitiveness against host of factors including tax rates.

2. LITERATURE REVIEW

The story of tariffs starts with 'infant industry argument' which is based on the proposition that developing countries, being late comer in the industrialisation process, need to protect their nascent industries from foreign competition. And if not protected, their industries shall be at disadvantage in the market due to uneven competition as activities of new firms are mostly costly compared to established firms. Higher cost of production for new firms creates a situation in which they cannot set prices of their goods high in free trade environment to recoup initial investment. Connected to the infant industry argument is the idea that there is lack of reciprocity in trade relations between developed and developing countries as developed industrial countries selectively implement the idea of comparative advantage. Rich countries advocate for a broad- based reduction in tariffs in less developed countries but they simultaneously employ protectionist policies against the import of primary products from the periphery. So there is unequal dynamics in 'core –peripheral relations' and in order to correct this imbalance, there is a valid case for policy of import substitution through tariff protection to local industry (Prebisch, 1959).

Economic history of industrialised countries is also brought in aid of infant industry argument. It is argued that today's developed countries practised significant degrees of protectionism for long periods and tariffs were used as part of 'selective industrial policy'. Professor Chang in one of his papers (Chang, 2009) writes: *"Britain and the US-the supposed homes of free trade- had the world's highest level of tariff protection during their respective catch-up periods (45-55 percent). This was no coincidence. Robert Walpole, the so- called first British Prime Minister, is credited to have been the first person to launch a comprehensive infant industry programme in 1721, strongly influencing Alexander Hamilton, the first Treasury Secretary of the US, who first developed the theory of infant industry protection. The targeted protection that Germany and Sweden provided to their nascent heavy industries in the late 19th and early 20th centuries are well-known, but even Belgium, one of the less protected economies, provided targeted protection. In the mid -19th century, when the country's average industrial tariff was around 10 percent, the textile industries had tariff rates of 30-60 percent and the iron industry 85 percent".*

The reason for rapid economic development of East Asian countries is also at least partially attributed to liberal use of industrial policy and application of tariffs for protection of local industry. This argument finds mention in the work of some leading economists of today. For example, Greenwald and Stiglitz are of the view that widespread presumption that free trade is good for growth is not vindicated by the development experience of successful countries as most of the successful countries like East Asian countries and USA used trade restrictions as explicit part of their growth strategies. They support use of tariffs as an instrument of trade policy but suggest that tariffs should be broadly and uniformly applied to industrial products instead of 'picking winners' by supporting particular industries as policy of picking winners is susceptible to creation of special interest groups vying for sustaining particular tariffs beyond their natural economic life (Greenwald, 2006).

Some economists,[12] considered staunch supporters of free trade, however, do not subscribe to the infant industry argument in case of development of East Asian countries

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[12]Paul Krugman, Jagdish Bhagwati and Arvind Panagariya are few names to mention in this regard.

on the ground that their development strategy was basically 'breakaway from the infant industry model'. According to them 'free trade' rather than 'protection and use of industrial policy' must be credited with boosting economic development of East Asian Tigers. Improved export incentives like duty-free inputs used in exports, exemption from indirect taxes, and elimination of overvalued exchange rates enhanced the profitability of not only existing export products but also potential export products in these countries. For example, initially wigs and human hair were entirely absent from South Korea's export basket but by 1970, they came to account for 10.1 percent of its total exports (Panagariya, 2019).

The success of Asian Tigers is primarily attributed to three key principals of industrial policy (Cherif et al, 2019). These principles were: (1) state intervention to fix market failures; (2) export orientation; and (3) the fierce pursuit of competition both foreign and local with strict accountability. Their success was not merely due to ISI rather export orientated policies of 1970s actually made the difference. In order to make their point, Cherif et al draw comparison of growth of Proton and Hyundai. The Malaysian government established proton with the objective to create local supplier cluster but Proton did not manage to export substantial number of cars in comparison with Hyundai as business model of Hyundai was export-oriented. So their point is that export orientated policies rather than ISI do explain miraculous success of Asian Tigers. The literature also suggests (Nathan, 2019) that shift of South Korea's economy to higher value added was due to 'investment incentives' and 'availability of imported intermediaries' rather than 'overt protection of domestic market of finished goods'.

The literature on tariff has also explored nexus between tariffs and economic growth. Most tariffs reduce growth both in the short-run as well as long-run (Osang & Pereira, 1996). Trade reforms which significantly reduce tariffs have a positive impact on economic growth, though effect is heterogeneous across countries (Irwin, 2019). For example, importing certain intermediate goods was outrightly banned under India's import substitution policy before liberalisation in 1990s whereas for number of input goods either licencing requirements were in place or import tariffs were high. In a bid to liberalise, India reduced average tariff rate from 90 percent to 30 percent during 1991 to 1997. This drastic reduction contributed to imports of input goods which more than doubled between 1987 and 2000. Resultantly, product space of firms increased and it is estimated that 30 percent of growth in new products was due to lower tariffs on input goods (Goldberg, *et al*. 2008). The Indian experience thus provides support to economic growth through 'variety in, variety out model'.

Domestic firms benefit from lower tariffs through access to cheaper, more sophisticated and new types of inputs goods from aboard (Rivera-Batiz & Romer, 1991; Romer, 1994). All types of tariff reductions, however, should not be expected to increase economic growth at the same rate and level. For example, reducing tariffs on final consumption goods is more welfare-enhancing for consumers but may not necessarily increase a country's potential growth in the same way as reduction in tariffs on capital and input goods may do by augmenting capital stock and improvement in technology. The countries which reduced tariffs on input and capital goods witnessed high growth accelerations compared to countries that reduced tariffs on consumption goods or the overall average tariff. The estimates of a study (Estevadeordal & Taylor, 2013) based on aggregate data of over 70 countries suggest that 25 percent reduction in the tariff on

capital and input goods increased economic growth for 'liberalisers' in the range of 0.75 to 1 percent compared to 'non-liberalisers' and there was clear divergence in the trajectory of growth of liberalisers and non-liberalisers.

The literature has also explored link between 'imported inputs' and 'productivity'. A study based on product-level data of Hungarian manufacturing firms for the period 1992-2003 has found that imported inputs have large productivity effects (Halpern et al, 2015). The said study hypothetically estimates that increasing the share of imported inputs from 0 to 100 percent increases productivity by 11 percent. Effects of tariff reduction on import of inputs and final goods in case of Indonesia, a comparable country with Pakistan, have also been documented ((Amiti &Konings, 2007). Results show that largest gains in productivity are associated with reduction in tariffs on imported raw materials or input goods. A 10 percentage point reduction in tariffs on final goods increases productivity by about 1 percent whereas an equivalent decrease in tariff on input goods leads to 3 percent productivity gain to for all domestic firms and an 11 percent productivity gain for importing firms. So at least there is a case of elimination/ reduction of tariffs on input goods. Reduction in tariffs at least improves productivity in following two ways. One, competition forces firms to become more efficient and reduce their costs to compete in the same market. Second, reduction/removal of tariffs on input goods gives domestic firms access to array of less expensive raw materials for producing output goods and help improve efficiency through the channels of lower prices, increased quality and increased variety of inputs. Reduction in input tariffs is also associated with better export performance. Access to cheaper and more varied inputs makes exporting firms more competitive. Evidence suggests positive impact of input tariff reduction on export market diversification, export survival, and export value (Cruz & Busolo, 2015). Evidence also suggests that firms in industries with greater input tariff reductions have higher probability to become exporters (Bas, 2012). Results of a paper in the context of Pakistan also suggest that input tariff reductions could boost Pakistani exports. On average 1 percent increase in the import of input goods increases the value of exports by 0.625 percent (Nida & Rabia, 2019).

Another strand of literature on tariffs has explored relationship between tariff reduction and consumer welfare. In this regard, a study done to examine effects of tariff reduction on import of vehicles in Colombia is worth mention. Prior to 1990, the automotive industry of Colombia was dominated by just three firms who were just assemblers.[13] They imported CKD kits which represented about 70 percent of the assembled car. In 1991, the Colombian government authorised entry of new assemblers and reduced tariffs both for CKD and CBU vehicles. The firms were allowed to assemble as many models as they could. Due to tariff reduction and liberalisation, new entrants entered into Colombian market. The new entrants acted just as importers of ready- to-sell vehicles in the market. As tariffs were reduced, previously unavailable cars entered into the market and prices dropped. As a result, consumer welfare increased to the tune of US$ 3000 but gains were mostly due to increase in variety of vehicles (Tovar, 2012).

The impact of gradual elimination of 20 percent tariff on 'printers' in India has also been documented and results suggest that out of low prices, higher quality, and

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[13]Their case seems very similar to that of Pakistan where assembling of vehicles is dominated by three Japanese assemblers.

greater variety, more gains were from higher quality of printers while contribution of price was slightly smaller (Sheu, 2014). So reduction in tariffs on cars by Colombia and printers in India suggest that liberalising imports increases consumer welfare not only through the channel of price but also through channels of variety and quality which in some cases are more important than the price channel.

Tariffs have also got macroeconomic consequences. Using a panel of annual data of 151 countries spanning over 1963-2014, IMF economists (Furceri, et al. 2019) suggest that tariff increases have adverse domestic macroeconomic and distributional consequences. They find empirically that increases in tariff reduce output and productivity, increase unemployment and inequality, and real exchange rate tends to appreciate as a result.

So the story of tariffs which started with the 'infant industry argument' tilts towards the opposite in the light of empirical studies which view tariffs not less than a sin and suggest salubrious effects of tariff reduction on industrial growth, productivity, exports, and consumer welfare. The trade revenues which are an integral part of the story in developing countries like Pakistan are generally missed in such studies while making a case for tariff reduction or elimination. Reduced use of tariffs means decreased usage of one of the administratively easy-to- collect taxes (Emran & Stiglitz, 2005). Tax revenues from personal income taxation are correlated with urbanisation, implying that in countries with large population residing in rural areas, revenue from domestic taxes cannot be that high (Tanzi, 1987). Moreover, it is not easy for developing countries to collect revenue from personal income tax due to slippages, non-documented economy, exemptions of certain sources of income like agriculture due to political economy issues, and weak tax machinery.

Further, any economic reform involving immediate loss in current revenue entails political and financial risks (Gordon, 2009). The VAT (sales tax in case of Pakistan) may not be an efficient tax and can lower growth and increase unemployment. VAT is regressive in nature but through import tariffs, a type of progressivity can be introduced by imposing higher tariffs on luxury goods consumed by the rich (Stiglitz, 2009). The recovery or replacement of lost trade tax revenue is hard to recoup in poor and developing countries as compared to middle and high income countries (Baunsgaard & Keen, 2010). In a nutshell, we can say that theoretically there is a good case for tariff elimination/ reduction at least on input goods due to massive benefits in the shape of productivity, export promotion, and economic growth but overall tax structure and revenue considerations cannot be altogether ignored while undertaking tariff rationalisation in a developing country like Pakistan.

3. OVERVIEW OF TARIFF STRUCTURE

3.1 General Overview

Pakistan Customs Tariff is based on Harmonised Commodity Description and Coding System i.e. Harmonised System (HS) 2017 comprising of 21 Sections and 97 Chapters. Chapter 98 pertains to Services (federal excise rates) and Chapter 99 is for special classification provisions.[14] The existing tariff structure has 5 slabs of 0 percent, 3

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[14]Chapter 99 of Pakistan Customs Tariff provides tariff concessions for variety of purposes like educational, research, health, diplomatic, and export processing zones etc.

percent, 11 percent, 16 percent and 20 percent slabs.[15] A new slab of 0 percent was introduced in 2019-20. Rates of CD of 30 percent and above are special rates generally for auto sector and alcoholic beverages. Edible oil, gold, silver and mobile phones are subject to specific rates of customs duty. Pakistan Customs tariff has total 7356 tariff lines. Above one third tariff lines fall under 0 percent and 3 percent slabs and one third tariff lines under the slab of 20 percent. (Table I).

Table I

Coverage of Tariff Lines Under Various Tariff Slabs

Sr.#	Tariff Slab	No. of Tariff Lines	No. of Tariff Lines (%)
1.	0%	1639	22%
2.	3%	1132	15%
3.	11%	1064	14%
4.	16%	566	8%
5.	20%	2448	33%
6.	30%	33	0%
7.	35%	280	4%
8.	50%	41	1%
9.	55%	16	0%
10.	60%	25	0%
11.	75%	14	0%
12.	90%	17	0%
13.	100%	31	0%
14.	Specific	48	1%
	Total	7356	

Source: Pakistan Customs Tariff (2019-20).

The number of tariff slabs, lowest rate of CD (floor) and highest rate (ceiling) have almost changed every year reflecting elements of inconsistency and uncertainly in tariff policy. The number of slabs, floor (minimum tariff rate) and ceiling (maximum tariff rate) for the last five years have changed as follows (Table II).

Table II

Change in Number of Tariff Slabs over Years

FY	No. of slabs	Floor	Ceiling
2012-13	8 to 7	0%	35% to 30%
2014-15	7 to 6	0% to 1%	30% to 25%
2015-16	6 to 5	2%	25% to 20%
2016-17	4 to 5	3%	20%
2019-20	4 to 5	0%	20%

Source: Various issues of Pakistan Customs Tariff 2012-13 to 2019-20.

[15] In total, there are 14 tariff slabs but more than 95 percent of imports are covered under 5 slabs.

The tariff is based on the principle of 'cascading' which means that import duty on raw materials/input goods shall be charged at lower rates whereas output or final goods should be subject to higher slab of duty. In the present scheme of things of Pakistan Customs Tariff, tariff slabs of 0 percent and 3 percent cover 2771 tariff lines of primary raw materials whereas tariff slabs of 11 percent and 16 percent generally cover semi-finished goods which are input goods for some producers while for some other producers, they may be output goods. For example, yarn is output good produced by spinning units of textile while for garment producers yarn is an input good. Similarly, HRC steel coils are input goods for the manufacturers of CRC while HRC manufacturers can use it as output good in line pipe manufacturing. In cases where a product is input for one sector while output for another, deviations from the cascading principle occur while setting tariff for such goods. Generally, cascading principle is the basis of tariff setting but deviations from this principle exist in tariff. The roots for such deviations can be traced in protectionism, political economy factors, or rent-seeking. The existing tariff of Pakistan broadly aims at protection of local industry through high tariff on output goods, concessions and exemptions for import substitution and export promotion, and revenue generation.

3.2. Protection Through High Tariff Rates

Pakistan followed protectionist policies from the very beginning on the strength of infant industry argument which was in fashion in 1950s. Effective rates of tariff were kept high to protect local industry. In 1963 effective rate of tariff protection to manufacturing sector was 271 percent, higher than many developing countries (Table-III).

Table III

Protection in Some Selected Countries in 1960s

| Year	Country	Effective rate of protection
1960	Mexico	26
1965	Philippines	61
1966	Brazil	113
1961	Chile	182
1963	Pakistan	271

Source: Bela Balassa, 1971.

About 50 years ago, Nyrop wrote about the situation of industry in Pakistan as follows:

"Industry is thin, overprotected, undertaxed and largely concentrated in the hands of a very restricted group. Because profits were, and continue to be high and opportunities were sufficient, private enterprise had ,at least until recently little incentive to venture beyond the areas of commerce, banking ,and import-substitution industry" (Nyrop,1971).

Manufacturing in particular remained heavily protected though it registered decline in effective protection rates since 1980s but compared to agriculture and services sectors, manufacturing import competing sectors still enjoy higher protection. A clear bias is visible

for manufacturing sector over agricultural and services sectors (Nadeem & Siddique, 2017). Pakistan, however, embarked on liberalisation programme since 1990s and gradually made drastic reductions in tariff rates. In year 2000, average MFN rate was around 25 percent which in year 2018-19 is 12 percent, so a reduction of over 100 percent occurred in MFN rates during this period. During 1990s, both international trade and government revenues were stagnant. Around 70 percent of government revenue was import-related. With the reduction in rates, both trade and revenue witnessed a quantum jump.

Decrease in Average Tariff Rates Over Years
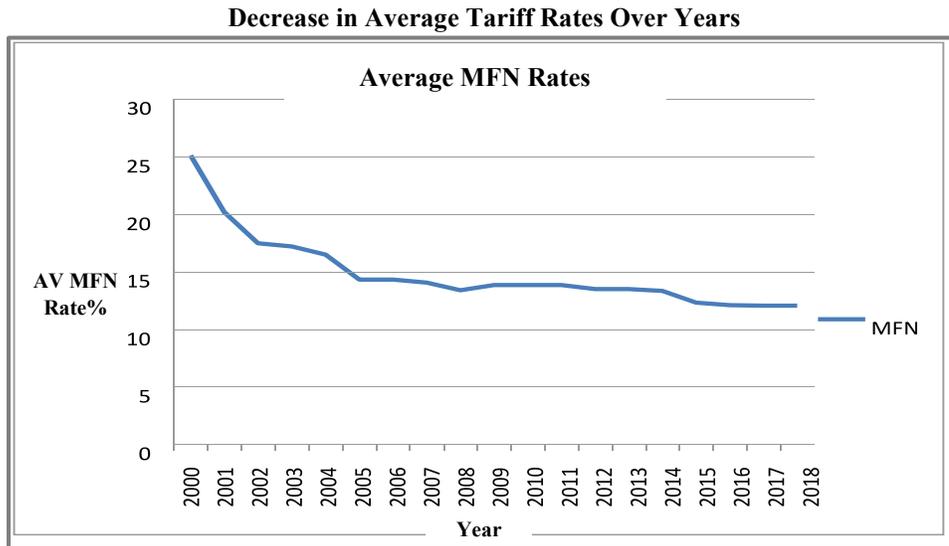
Source: Indexmundi (https://www.indexmundi.com) and WTO Tariff Profiles for various years.

Despite huge reduction in average MFN rates, the fact is that the tariff slab of 20 percent still covers the highest number of tariff lines. The tariff slab of 20 percent or higher generally apply to the goods 'manufactured locally' and high rate of tariff is meant to protect these industries from foreign competition. In total 2448 tariff lines fall under this slab implying that revenue generation and protection of local industry are important objectives of existing tariff structure and perhaps consumer welfare is not assigned much weightage in tariff setting process. Slabs higher than 20 percent are specifically meant to protect the auto industry where completely built units (CBUs) /vehicles attract maximum rate of customs duty to protect local assemblers of vehicles and their vendors.

Besides customs duty, additional customs duty (ACD) and Regulatory duty (RD) are also charged at the import stage in numerous cases. These duties basically serve three purposes i.e. protection of local industry, import compression to fix balance of payments issue and revenue generation.ACD was increased in the budget for FY 2019-20 as a 'revenue measure' from flat rate of 2 percent to 2 to 7 percent. CD slabs of 0-11 percent were subjected to ACD @ 2 percent, whereas slab of 16 percent and 20 percent were subjected to ACD @ 4 percent and 7 percent respectively. ACD is, however, not levied on imports under several exemption SROs and schedules.[16]

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[16]For example imports under 5th schedule to the Customs Act, 1969 which provides concessionary rate of CD to various goods and industrial inputs is not subject to ACD.

RD has also traditionally remained an important tool of protection and import compression. In 2017, 08 various SROs of RD covering 1194 tariff Lines were merged into a single SRO 1035(I)/2017 dated 16.10.2017. This SRO subjected 1505 tariff lines to RD. In FY 2018-19, RD regime was extensively reviewed and new SRO 640(I)/2018 dated 24.05.2018 covering 1691 tariff lines was issued and finally at the time of budget for the FY 2019-20, RD regime was again reviewed and SRO 680(I)/2019 dated 28.06.2019 imposing RD on 2075 tariff lines was issued. Officially, it is claimed that focus of RD is not revenue generation and RD is meant to fix balance of payments issue by reducing import of luxury goods but for all practical purpose RD serves the motive of revenue generation at least in the short to medium term (Pursell et al, 2011) but imposition of RD rather than increasing revenue generally proves counterproductive as overall customs revenue falls due to decrease in legal imports. The increasing scope and coverage of RD and ACD with each passing year points towards the fact that they are now being used not only as protectionist tools of tariff policy but for revenue generation at import stage, though overall revenue of customs may fall in the medium to long-term due to said levies. Since 2015-16, over 5000 tariff lines are subject to ACD whereas 1309 tariff lines were subject to RD in 2015-16 which increased to 2075 tariff lines in 2019-20 (Table -IV).

Table IV

Expanding Coverage of ACD & RD

Year	No. of Tariff lines where ACD charged	No. of Tariff lines where RD Charged
2015-16	5535	1309
2016-17	5741	1505
2017-18	5996	1682
2018-19	5888	1994
2019-20	5521	2075

Source: SROs of RD and ACD and PRAL data.

There is lobbying from local manufacturers through their Associations and concerned Ministries for levy of these duties on imports. Pressures are applied by protectionists and political economy considerations are at play for imposition of RD to provide shield to the local industry against foreign competition. The liberal use of ACD and RD are aberrations from the normal tariff structure and tariff policy applying such tools of protectionism does not necessarily reflect the interests of the consumers and general public. Lobbying and pressures by special interest groups reminds of 'protection is for sale model' (Grossman & Helpman, 1992) where interest groups bid for protection and influence the government to use trade policy to transfer income though protection.

3.3. Revenue Imperative

Over the years, Pakistan has developed a system of collection of direct taxes in the mode of indirect taxes. Withholding tax (WHT) , which is income tax for all theoretical and parctical purposes , is collected at import stage @ 6 percent[17] which simply means that it is not being charged against income but against 'imported goods' from which the importer has not yet earned any income. Similarly sales tax is also collected at import stage @ 17 percent with some exemptions and in certain cases reduced rates. The

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[17]In case of non-filers existing rate is double i.e. 12 percent.

multiplicity of taxation at import stage points towards not only high incidence of taxation but complexity of the taxation structure of Pakistan. On average, 45 to 50 percent of total revenue of FBR is customs-dependent. Out of this collection major chunk is of sales tax and withholding tax as amply clear from the data tabulated below (Table V).

Table V

Revenue Collection of Import Stage

Year	Total FBR Revenue Collection of FBR	Revenue Collection at Import Stage	Revenue Collection at Import Stage (%age)	*Part of CD in Revenue Collection	Part of CD in Revenue Collection (%age)
2014-15	2059	1023	50	306	15
2015-16	3112	1273	41	405	13
2016-17	3361	1371	41	497	15
2017-18	3844	1651	43	608	16
2018-19	3828	1732	45	686	18

Source: Various issues of Pakistan Year Book.
    * It includes amount of ACD & RD as well.

Thus customs import duties are not solely responsible for high tax burden at import stage. High incidence of taxes at import stage motivates firms to underdeclare, misdeclare, misinvoice, and smuggle. Two perennial problems of Pakistan Customs i.e. under- invoicing and smuggling are largely due to high incidence of taxes on imports. The literature suggests that tariff rates have positive effect on import tax evasion (Mishra, et al. 2007). A one percentage point increase in tariff rate tends to increase trade gap by 0.6 percent and in case of differentiated goods increase in trade gap is around 2.1 percent (Javorcik & Narciso, 2007). Findings of another study suggest that one- percentage-point increase in the tax rate is associated with a three-percentage-increase in evasion (Fisman & Wei, 2004).

In case of Pakistan, estimates suggest losses of more than \$92.7 billion due to misinvoicing during 1972 to 2013 for 52 major traded commodities. The gross revenue loss to the national exchequer is estimated at \$21.1 billion during said period. The annual average net revenue loss is estimated around 11.2 percent of revenue from tariffs (Qureshi & Mahmood, 2016). Pakistan Business Council (PBC, 2014) estimates losses of Rs.150 billion each year due to under-invoicing whereas total loss due to under-invoicing, smuggling, and misuse of concessionary regime is estimated at Rs.600 billion per annum. There are guesstimates that under invoicing through Chinese border is causing loss of revenue in the range of US\$ 4 to 6 billion per annum.[18]

Increase in tax rates or additional levies have been used as tools of tariff policy under the assumption that increase in tariff rate or additional levy shall increase revenue in a simple linear relationship. This premise is fundamentally a fallacious assumption. Increase in import tariffs not only reduces competitiveness of businesses but also promotes tariff evasion through misdeclaration, under- invoicing, smuggling, and corruption.

[18]Refer to 'Pakistan asks China to provide real-time data to avoid under-invoicing' , *The News* , Dec. 12, 2019.

3.4. Concessions and Exemptions

The concessions and exemptions may broadly be divided into three categories. First category of concessions is meant for import substitution through encouraging local manufacturing protection to various sectors of economy. The firms are allowed to import input goods on concessionary rate i.e. below statutory rate. These concessions/ exemptions are available to auto sector, CRC manufacturers, fan manufacturer, assemblers of home appliances, manufacturers of fertilisers, pharmaceuticals, textile sector, plastic product manufactures, leather and tanning, manufacturers of diapers, mobile phone manufacturers, and manufactures of optical fiber etc. under various SROs[19] and 5th schedule of the Customs Act, 1969. These concessions are generally available subject to certain conditions like quota determination by IOCO or certification by some Department/Agency.

Second category of exemptions relates to general exemptions under chapter 99 of Pakistan Customs Tariff. These exemptions are available to foreign dignitaries and foreign organisations, imports by charitable, educational and scientific institutions, hospitals, export processing zones and special economic zones etc. These exemptions are available on fulfillment of certain conditions like certification from relevant regulatory departments and Ministries to the effect that goods shall be used for the purposes they have been imported for.

There are several schemes for exporters which allow duty-free import of inputs used in output goods meant for exports. These schemes facilitate main export sectors like textile, leather goods, sports goods, surgical goods, carpets, footwear, engineering goods, metal products etc, in particular. In all these schemes, duties and taxes on imported goods which are used in output goods meant for subsequent exports enjoy exemption from payment of duties and taxes against certain conditions. The existing schemes which provide concessionary tariff for export promotion are briefly as follows.

The manufacturing bonds (MBCO) scheme allows manufacturer-cum-exporters to import duty-free inputs for subsequent export of value added products. The firm is required to obtain a licence for availing this scheme which is granted subject to fulfillment of certain conditions laid down in the customs rules. The firm is also required to obtain a certificate called "analysis certificate" from IOCO which allows importing firm to import duty- free inputs as per analysis certificate. The firm is required to give complete accountal of the input goods, output goods, and the quantum of wastage occurred during the production process. This accountal is required under the law to be furnished to the regulatory authorities in the form of regular statements/ returns. The firm is also subject to yearly audit by the Customs authorities wherein compliance of the firm to the rules and conditions of the licence, input-output ratios laid down in the analysis certificate, adherence to time period of consumption of input goods, and export of output goods is invariably checked. In case of big firms, import and export record is voluminous and audit may practically take months.

Another scheme is EOU scheme which operates under Export Oriented Units (EOU) and Small and Medium Enterprises Rules. This scheme not only allows import of

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[19]For example SROs 656 (I)/2006 and 655(I)/2006 respectively provide exemption from CD to OEMs of automotive manufacturers and their vendors while SRO 565 (I)/2006 provides exemption from customs duty on raw materials, sub- components, sub-assemblies, and assemblies for local industries.

duty and tax free input materials but also allows duty and tax free import of plant, machinery, equipment, apparatus, including capital goods. Besides raw materials, accessories, sub-components, components, assemblies, sub-assemblies, this scheme also allows duty and tax free import of coal, diesel, gas, furnace oil, and coke of coal used in the manufacture of output goods for export. Though scheme operates under EOU and SME Rules but rules do not define a SME and scheme is hardly availed by small and medium enterprises. The firms have to obtain licence to operate under this scheme and post-exportation audit is conducted at the close of every financial year where record of input goods, exported goods and their matching with input-output ratios is essentially checked.

The Duty & Tax Remission for Exports (DTRE) Scheme is another scheme meant for export promotion. Besides imported inputs, DTRE-holder can purchase local inputs without payment of duty and taxes. This scheme can be availed by Sales Tax registered exporters, commercial exporters, contracted vendors of foreign manufacturers and persons engaged in value-addition in export goods. This scheme also covers supplies made against international tenders, EPZs, projects entitled to duty and tax-free inputs and supplies made by indirect to direct exporters. Each DTRE approval is per se an entity and audit is conducted on utilisation of each DTRE. The bank guarantee[20] is obtained at the time of granting DTRE approval to secure the amount of taxes which is released on completion of satisfactory audit.

The scheme of temporary importation is also available to exporters. This scheme entails suspension/exemption of duties and taxes for import of accessories used for manufacture of exportable goods. This facility can be availed for duty-free imports of components, sub-components for assembly of machinery, electrical and electronic equipment, bicycles, aluminum ware, steel ware, kitchen utensils, surgical instruments, toys, decorative items, stationery items, etc. meant for exports. This scheme is easier to use compared to other export facilitation schemes. No licence is required to operate under this scheme. At the import stage post dated cheque (PDC) is secured for suspended amount of duty and taxes which is released after exports. This scheme is seemingly an easier scheme to use as it neither requires licence to operate nor bank guarantee etc.as security like that DTRE scheme. As the scheme is not importer-specific rather goods-specific, so GD is the basic unit to ascertain the level of utilisation etc. of this scheme. So while analysing utilisation level in the next section, this scheme shall not become part of discussion.

In addition to above mentioned schemes, there are schemes of export processing zones and special economic zones etc. for promotion of exports and industrialisation in the country. The scheme of export processing zone is the oldest scheme for promotion of exports but the quantum of exports under this scheme has stagnated around $ US 250 to 300 million per annum since last many years.

Despite multiple duty-free schemes, the general perception among the exporters is that they are not-easy-to-use. Elaborate documentation is required for availing them. These schemes are generally utilised by established firms, whereas

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[20]The type of financial instrument has got implications from the perspective of cost for business. In case of bank guarantee, the exporter has to bear financial costs as he has to pay charges for the trust reposed in him by the bank. In case of PDC, no such cost is involved.

small and medium enterprises and entrepreneurs find them difficult to use.[21] They buy raw materials and industrial inputs from open market through commercial importers. It increases their cost of production, thus rendering them at disadvantageous position in comparison to large firms which besides benefitting from such schemes have also got an inbuilt advantage over small firms in the form of economies of scale.

3.5. Where does Pakistan Stand in the Region?

Pakistan followed policy of protectionism but in the regional scenario especially compared to India and Bangladesh, Pakistan fares well in terms of tariff rates. In 2018, average MFN rate of Pakistan is 12.1 whereas for India and Bangladesh these rates respectively are 17.1 and 14 though MFN rates of China, Indonesia, Malaysia are much below than Pakistan (Table VI).

Table VI

Average Tariff Rate of Selected Countries

Country	Avg MFN Rate (2018)
Pakistan	12.1
India	17.1
China	9.8
Sri Lanka	9.3
Bangladesh	14.0
Indonesia	8.1
Malaysia	5.6

Source: Indexmundi (https://www.indexmundi.com) and WTO Tariff Profiles for various years.

Similarly when we analyse average MFN rates with respect to product groups in the region, Pakistan fares better than India and Bangladesh. Textile sector enjoys more protection in India and Bangladesh compared to Pakistan. Similarly MFN rate for machinery upon which entire edifice of industrial development is built is lower in Pakistan compared to Bangladesh and India (Table VII).

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[21]For example SRO 565 (I)/2006 provides exemption of CD on 'non-grain oriented electrical steel sheet' (PCT 7225.1900) to fan manufacturers subject to quota determination by IOCO. There is a reasonable number of fan manufacturers in the country but only two to three big manufacturers avail this exemption and small and medium sized manufacturers purchase this input good from local market. In this way, exemptions or concessions provided through SROs in a sense favour the big and established concerns while new entrants and SMEs are at disadvantage.

Table VII

Average Tariff Rates of Various Product Groups

Product Group	Pakistan	India	China	Indonesia	Sri Lanka	Bangladesh	Malaysia
Minerals & Metal	11.2	11.0	7.8	7.1	8.0	12.8	7.1
Chemicals	7.9	10.1	6.7	5.3	3.0	9.7	2.5
Textiles	15.3	20.7	9.6	11.5	2.0	19.5	8.8
Clothing	19.8	20.5	16.0	23.9	0.0	24.4	0.2
Leather, Footwear etc	14.0	12.1	13.2	9.9	15.0	14.3	10.3
Non-electrical machinery	7.2	7.8	8.1	5.4	2.7	4.0	3.2
Electrical machinery	13.0	8.8	8.4	6.0	6.2	13.5	3.9
Manufactures n.e.s.	11.2	11.1	11.6	7.5	10.0	12.8	4.5

Source: WTO (2018). n.e.s. = not elsewhere specified.

If we trace the pace of liberalisation since 2000 taking average MFN rate as the proxy variable for liberalisation, Pakistan has liberalised comparatively faster than India and Bangladesh. In year 2000, the average MFN rates for Pakistan, India, and Bangladesh were respectively 25.16, 35.56, and 21.64 which in year 2018 respectively stand at 12.1, 17.1 and 14. Implication simply is that Pakistan has liberalised more compared to India and Bangladesh in last two decades. The MFN rates of other regional countries like China, Malaysia, and Indonesia were much low compared to Pakistan in 2000.Their MFN rates are lower compared to Pakistan, India and Bangladesh in 2018 as well (Table VIII).

Table VIII

Comparison of Most Favoured Nation, Simple Mean, All Products (%)

Year	Pakistan	Bangladesh	China	India	Malaysia	Indonesia	Sri Lanka
2000	25.16	21.64	16.99	36.56	9.84	8.43	9.96
2001	20.24	20.61	15.88	34.91	9.2	6.9	9.88
2002	17.53	20.67	13.11	30.59	8.33	6.91	9.88
2003	17.26	19.52	11.36	26.92	9.46	6.91	9.36
2004	16.54	18.43	10.52	29.51	13.53	6.96	10.43
2005	14.37	15.31	9.81	19.02	7.32	6.96	11.71
2006	14.37	15.3	9.87	16.8	7.67	6.96	11.5
2007	14.11	14.57	10.01	17.2	8.19	6.91	11.4
2008	13.45	14.74	9.7	12.81	8.15	6.9	11.28
2009	13.91	14.44	9.62	13.06	8.59	6.8	11.31
2010	13.91	14.43	9.74	12.51	6.67	7.39	10.41
2011	13.91	14.42	9.8	13.36	6.25	7.42	10.3
2012	13.56	14.58	N/A	14.04	6.25	7.36	10.47
2013	13.55	13.93	N/A	13.93	6.26	7.22	N/A
2014	13.39	13.88	9.67	13.16	5.12	N/A	9.65
2015	12.38	13.88	11.04	13.72	N/A	N/A	8.29
2016	12.16	13.9	10.93	13.75	5.78	7.88	10.26
2017	12.1	13.9	11.01	N/A	5.8	8.1	8.1
2018	12.1	14	9.8	17.1	5.6	8.1	9.3

Source: Indexmundi (https://www.indexmundi.com) and WTO Tariff Profiles for various years.

So the point emerges that Pakistan provided protection through tariff, devised several schemes of exemption of duty and taxes for export promotion and its average MFN rates are lower at least compared to two regional comparators i.e. India and Bangladesh but its exports have stagnated. The pace of industrial growth is slow and competitiveness is eroding in the international market. Manufacturing industries are lagging behind in terms of technological advancement and adaptation causing low value added and low quality export products

(Mahmood, et al. 2009). Part of explanation lies in protectionism itself as due to lack of competition from abroad firms were least incentivised to upgrade their processes as happened in case of textile sector. Factors like lack of skilled workforce, electricity and gas shortages etc. are also partly responsible for low productivity of manufacturing sector but role of import substitution policies and tariffs also cannot be ruled out (Mahmood et al, 2007). The trade liberalisation proxied by import duties has positive though negligible effect on the TFP (Ahmed, et al. 2017). The tariffs have aimed at short-term gains of revenue at the expense of sustainable economic growth and the complexity of tariff structure and not-easy-to-use export promotion schemes are certainly responsible for slow industrial growth and exports.

4. ANALYSIS AND DISCUSSION

4.1. Protection

Traditionally, broad objectives of Tariff in Pakistan have remained import substitution, export promotion through protection by keeping high rates of tariff on output goods, reduced rates or exemptions of import duties on raw materials/input goods, and revenue generation. The current tariff structure places finished goods, generally manufactured locally, under the highest slab of 20 percent. This slab is also subject to highest rate of additional customs duty (ACD) of 7 percent and numerous output goods falling under this slab are also subject to regulatory duty (RD). Protection of locally manufactured goods is a clear objective of tariff policy. CGO 2/2017 provides a list of 1106 locally manufactured goods, which even if otherwise eligible for exemption or concession through some SRO, are not entitled for such concession or exemption in import duties. Two sectors i.e. textile and auto in particular have enjoyed and still enjoy heavy protection.

Yarn, fabrics and garments have high incidence of duty and taxes at import stage to protect local manufacturers. Yarn is currently subjected to 5 percent[22] CD, 2 percent ACD, 5 percent RD, 17 percent sales tax at import stage and 1 percent WHT, so the total incidence of duty and taxes at import stage comes to 30 percent. In case of cotton fabrics incidence is around 55 percent (CD 20 percent, ACD 7 percent, RD 10 percent, ST 17 percent and WHT 1 percent). The readymade garments classifiable under chapter 62 and 63 of Pakistan Customs Tariff are subject to 20 percent Customs Duty, 7 percent Additional Customs duty and 10 percent regulatory duty in addition to 17 percent Sales tax and 6 percent withholding tax. The total impact of duty and taxes is thus around 60 percent. Even the garments imported in old and used condition are subject to 3 percent CD, 2 percent ACD, 10 percent RD, 5 percent sales tax and 6 percent WHT, thus bringing the aggregate incidence to 26 percent which is to be paid by the poorest of the poor. The output goods are subject to high incidence to give protection while input goods are either duty-free or enjoy concessionary rate of duty and taxes. Several schemes mentioned in the previous section are also available to this sector which allow duty-free import of input goods and machinery.

Despite all protection, textile sector's share in the GDP and exports is almost stagnant and this sector has not been able to increase its share in value addition, diversify product range or boost exports despite having preferential access to European market through GSP+ etc. So problems are basically of supply-side. Shield from foreign
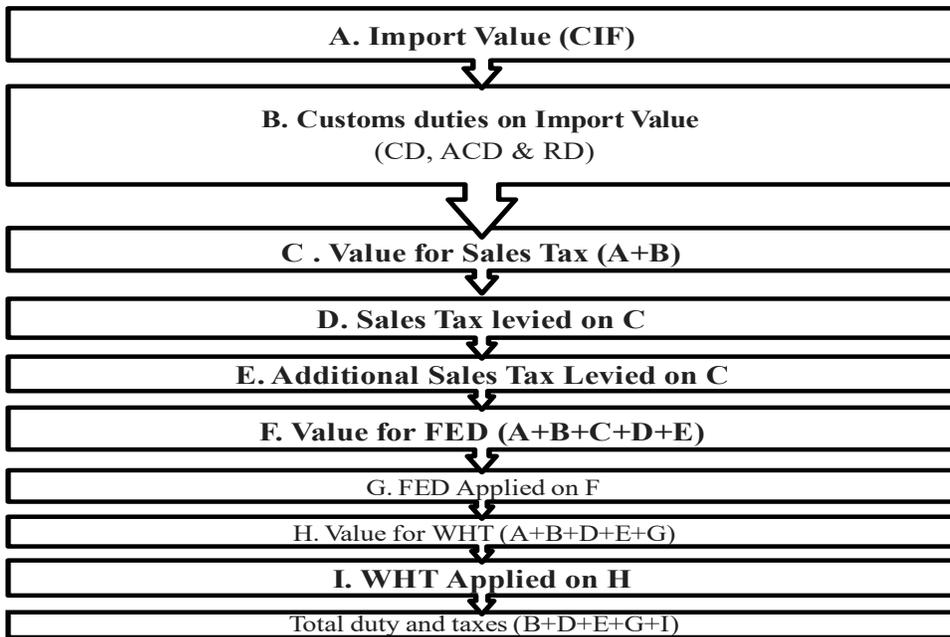
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[22]Statutory rate is 11 percent but 5th Schedule provides concessionary rate of 5 percent.

competition to this sector has provided a captive local market with little incentive to improve quality, upgrade technology and invest in R&D. The protectionism based on infant industry argument, without an exit strategy and sunset date, hardly guarantees success in the long-run as vindicated by textile sector of Pakistan. The beneficiaries of protectionism get accustomed to reaping windfall profits and Protectionism as strategy of industrialisation, if left open, may turn out to be counterproductive for long-term economic growth.

The other significant example is of auto sector where protection has been provided through tariff on import of new vehicles in CBU condition. Custom duties range from 50 percent to 100 percent, ACD 7 percent, RD from 15 percent to 90 percent , Sales tax 17 percent,   WHT 6 percent in addition to federal excise duty ranging between 2.5 percent to 30 percent. The total incidence of duty and taxes in the maximum slab of vehicle if imported in CBU condition comes to around 250 percent.

4.2. Import Levies on Tariff - Inclusive Price

Withholding taxes, sales tax and federal excise taxes etc. are calculated on the tariff-inclusive price[23]   which means that incidence of import taxes and protection are implicitly higher than visible from tariff rates given in the code. A flow chart showing calculation of various import levies is as follows:

A. Import Value (CIF)

B. Customs duties on Import Value (CD, ACD & RD)

C . Value for Sales Tax (A+B)

D. Sales Tax levied on C

E. Additional Sales Tax Levied on C

F. Value for FED (A+B+C+D+E)

G. FED Applied on F

H. Value for WHT (A+B+D+E+G)

I. WHT Applied on H

Total duty and taxes (B+D+E+G+I)

[23]The Customs Value is determined in accordance with provisions of Section 25 and 25 of the Customs Act,1969. The provisions of section 2 (46-d) of Sales Tax Act,1990 provide that value for sales tax purposes would be the value determined under Section 25 or 25 A of the Customs Act,1969 plus the CD of all species. Section 148(9) of the Income Tax Ordinance, 2001 provides that value of goods for the purposes of WHT means the value of goods as determined under the Customs Act,1969 as if the goods were subject to ad valorem duty increased by the Customs-duty, federal excise duty and sales tax if any payable in respect of the imported goods.

Let us do little math to understand the intricacies of tax assessment at import stage on tariff- inclusive price to draw inferences. Let us take example of a luxury vehicle of over 30000 CC having hypothetical import price of US $ 40,000. The calculation of different duties and taxes at import stage is as follows (Table IX).

Table IX

PCT 8703.2340 (Cars & Jeeps above 3000 CC)

	Head	Rate of Duty	Amount (Rs)
A	Import Value US $	US $	40,000
B	Insurance	1%	400
C	Import Value + Insurance		40,400
D	Freight	1%	404
E	CIF Value (A+B+D) US $		40,804
F	Import Value in Pak Rupees (@155)		6,324,620
G	CD	100%	6,324,620
H	ACD	7%	442,723
I	RD	70%	4,427,234
J	Value for ST (F+G+H+I)		17,519,197
K	ST	17%	2,978,264
L	AST	3%	525,576
M	Value for FED (J+K+L)		21,023,037
N	FED	30%	6,306,911
O	Value for WHT (M+N)		27,329,948
P	WHT	12%	3,279,594
Q	Total duty & taxes		24,284,922
R	Share of import duties in total taxes		46% (approx)
S	Share of other taxes at import stage		54% (approx)
T	Taxes other than import duties on tariff-inclusive price (ST, AST, FED, & WHT)		13,090,344
U	Other taxes on tariff-exclusive price	62% of import value	3,921,264
V	Difference (T-U)		9,169,080

Total duty and taxes come to Rs.24.3 million based on calculation of taxes like sales tax, FED and withholding tax on the basis of tariff-inclusive price out of which Rs.13 million are approximately other than customs duties leviable at import stage. If calculations are made on tariff-exclusive price, then quantum of other taxes is just around Rs.3.9 million. The difference in calculation method gives difference of over Rs.9.2 million. Tax assessment on the basis of tariff-inclusive price has, however, been given legal cover under the relevant statutes and this method is in line with other countries where revenue from import stage is a major consideration.

In case of import of a small car of 800CC to 1000CC having hypothetical price of US $ 5,000 (around 0.8 million in Pak rupees), duty and taxes calculated on tariff-inclusive price are over Rs.1.1 million out of which share of customs duties is

approximately 54 percent while of other taxes is 46 percent . The amount of import levies other than customs duties is Rs. 0.6 million and if calculation is made on the basis of tariff-exclusive price, the amount of taxes (other than customs duties) comes to Rs. 0.27 million. Detailed calculation is given at Annexure-A1.

Let us do some math for textile sector as well. Let us assume hypothetical import price for a container of cotton T-shirts is Rs.2 million. Total duty and taxes based on tariff-inclusive price come to Rs. 1.4 million approximately out of which taxes at import stage other than customs-duties are Rs.0.66 million. Tax assessment on the basis of tariff-exclusive price is Rs. 0.46 million. Detail is at Annexure A-2. Results are similar in case of import of a container of old clothing meant for poorest of the poor segment of the society. Let us assume hypothetical import price of a container of old and used clothing is Rs. 0.93 million. The total amount of duty and taxes comes to Rs. 0.4 million approximately out of which taxes other than import duties constitute 65 percent share (Rs. 0.26 million) on the basis of tariff-inclusive price assessment. If hypothetically these taxes are calculated on tariff-exclusive price, then the amount of taxes other than customs duties comes to Rs. 0.21 million. The detailed calculation is given at Annexure A-3.

Following points become very much visible from above exercise in math. *First*, protection in actual is high compared to the rates visible to the naked eye in the tariff code. *Second*, valuation of imported goods is closely linked to tariff structure. *Third*, incidence of duty and taxes is high at import stage with all incentive of undervaluation and misdeclaration. *Fourth*, calculation of other import levies on tariff- inclusive price shows that tariff is being used to maximise revenue collection from other taxes like sales tax, withholding tax, and federal excise duty as well.

Protection has not been provided only through tariff, protection through non-tariff barriers (NTBs) is also very much visible. A large number of tariff lines are subject to some type of condition or licence under Import Policy Order (IPO). The protection though NTBs is not subject matter of this paper, so I shall not delve into it but to make the point only reference is made to a change in IPO regarding import of old and used vehicles. Import of old and used vehicles is not allowed under the law except for expatriate Pakistanis under baggage, TR, and gift schemes. Prior to the MoC notification that remittance for payment of duties and taxes should come from the account of Pakistani national sending the vehicle from abroad, said schemes provided a little bit competition to the auto assemblers though circumvention of legal provisions. The old and used vehicles were imported by the investors on the passports of expatriate Pakistanis and then sold in the local market which filled the gap between local production of cars and demand in the market. A comparison shows that 3797 vehicles were imported under said schemes during July to December 2019 compared to corresponding period of 2018 during which 28000 vehicles were imported, thus registering a decrease of more than 86 percent in quantity terms[24] (Table XIII).

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[24]SRO52 (I)/2019 was issued on 15th of January, 2019 by the MoC. So in the period July to December, 2019, condition of the remittance originating from the account of the sender of the vehicle was not there, so comparison between July-December 2018 with the corresponding period of 2019 gives a fair idea of the impact of said SRO on import of vehicles through schemes for expatriate Pakistanis.

Table X

Import of Vehicles (PCT 87.03) under Baggage TR and Gift Schemes
*(July to December)*

(Rs. in Million)

Year	2018	2019	%Growth
Quantity (in numbers)	27986	3797	-86.4
Import Value	19812	3326	-83.2
Duty and Taxes	22657	3670	-83.8

Source: FBR/ PRAL data base.

Due to protectionist policies, the auto assemblers bloated the prices of cars unnaturally and compromised on quality and safety features such as dual air bags or side impact bars etc. The deletion program was not implemented fully and even now 60 percent parts of these vehicles are being imported. In the last two years or so, protectionism of auto industry has, however, led to entry of 18 new assemblers in the market. Very few have started production yet. It is, however, premature to comment whether protection to auto sector and entry of new entrants shall increase consumer welfare through reduction in prices and increase in variety.

Can we observe any relationship in tariff rates reduction and industrial growth? Let us take large scale manufacturing growth as proxy for industrial growth and draw a graph showing average MFN rates, LSM growth rates and overall GDP growth rates. A negative correlation can be observed between reduction in MFN rates and growth rates of LSM starting from year 2000 till 2008 but after 2008 this relationship becomes bit tenuous. Eroding competitiveness due to power crisis may be a plausible explanation for weakening of negative relationship between the two variables. Interestingly, relationship between economic growth rate and MFN tariff rate reduction is, however, noisy and any pattern between tariff reduction rate and GDP growth rate is difficult to figure out.

MFN, GDP, LSM Growth Over Years
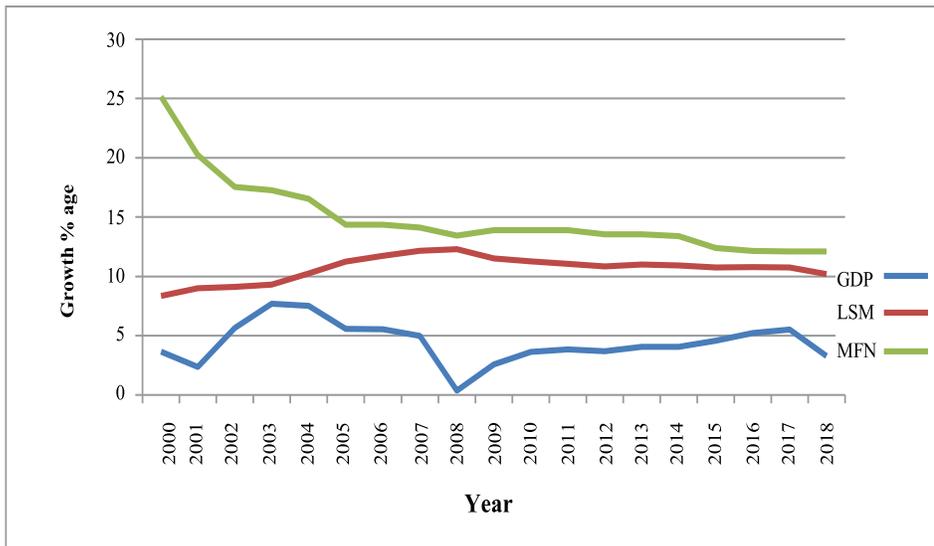
4.3. Zero Tariffs versus Exemptions

Several exemption schemes exist for export promotion Input goods are either exempt from import tariffs or attract lowest slab of customs duty but despite all this, exports of Pakistan have almost stagnated. Industrial productivity is low and competiveness of Pakistani firms is eroding. Tariff structure cannot be seen in isolation. Factors like total incidence of duty and taxes at import stage, valuation method, time taken for customs clearance, informal costs, and degree of ease in utilisation of exemption schemes are directly connected to tariff structure. The complexity of exemption schemes increases burden on firms. Low utilisation of duty exemption schemes is indicative of the fact that they are not easy to use especially for small and medium exporters. A comparison of four major export oriented schemes (MBCO, DTRE, EOUs and EPZ) shows that around 5 percent exporters, making 31 percent exports, availed these schemes in 2017-18. This number increased to around 6 percent in 2018-19 and volume of exports to 37 percent. Out of total 15000 exporters, around 5600 exporters make just up to Rs. 5 million exports per annum and if we increase export limit to Rs. 10 million , then number is above 7000 (about 50 percent) of total exporters though their volume of exports is just around 1 percent of total exports (Table-XIV, XV and XVI).

Table XI

Utilisation of Export Oriented Schemes

(Rs. In Million)

Export Schemes	No. of Units	Total Value of Import	Total Value of Export	No. of Units	Total Value of Import	Total Value of Export
	FY (2018-19)			FY (2017-18)		
Duty & Tax Remission for Export (DTRE) Scheme	242	82,520	203,996	231	67,819	171,038
Manufacturing Bond	237	106,307	262,493	214	95,933	174,303
Export Oriented Units (EOUs)	132	34,882	598,862	124	75,055	373,034
Export Processing Zones (EPZ)	210	53,226	80,727	209	43,711	71,090
Total	821	276,935	1,146,078	778	282,518	789,465
Total No. of Exporters		14,925			14,564	
%age of Exporters		6%			5%	
Total Export Value of Pakistan		3,139,462			2,562,299	
%age of Export Value		37%			31%	

Source: FBR/PRAL data base.

Table XII

Categorisation of Exporters in Terms of Export GDs FY(2018-19)

Slab	Total No. of Exporters	Count of GDs	Total Export Value (Rs. Million)
Upto 12 GDs	8,966	37,361	120,818
13 to 24 GDs	2,051	36,159	157,865
25 to 50 GDs	1,691	59,200	262,733
Above 50 GDs	2,217	660,931	2,598,046
Grand Total	**14,925**	**793,651**	**3,139,462**

Source: FBR/ PRAL data base.

Table XIII

Categorisation of Exporters in Terms of Export Value FY(2018-19)

Slab	Total No. of Exporters	Count of GDs	Total Export Value (Rs. Million)
Up to 5 Million	5,617	19,569	11,052
5 to 10 Million	1,657	14,697	12,884
10 to 30 Million	2,589	39,528	48,092
Above 30 Million	5,062	719,857	3,067,434
Grand Total	14,925	793,651	3,139,462

Source: FBR/ PRAL data base.

Presence of reasonable number of exporters, though having small contribution in total exports, has an important policy insight. These exporters are exposed to dynamics of international trade, can handle export-related documentation, and are able to search buyers in the international market. They may be credit-constrained or wary of using concessionary/ exemption schemes meant for exports. Presently, there is no separate duty and tax incentive scheme for small and medium enterprises and exporters. The EOU rules have been named as Small and Medium Enterprises Rules but hardly EOU scheme is utilised by small and medium exporters. If small and medium enterprises/ exporters become focus of policy, there is strong possibility to enhance export growth of Pakistan. Huge potential lies in small and medium enterprises which need to be tapped through SME-friendly policies and initiatives.

4.4. Cap—Cape Relation

Why does availing import-duty exemption schemes become costly? To illustrate the point, let us assume an importing-cum-exporting firm which imports input goods duty-free under a scheme of exemption. It incurs some formal and informal costs at port. Formal costs may include ground handling charges/ labour charges for stuffing and destuffing a container for examination and port charges etc. while informal expenses i.e. out of pocket expenses may include informal payments paid at the port. Let us call these formal and informal charges 'Cost at Port (CAP)'. Additionally, the firm availing an exemption scheme like manufacturing bond, EOU or DTRE has to operate under a licence. It incurs costs in terms of time and money related to issuance of licence and analysis card, record keeping, and providing monthly or quarterly statements to the regulator for audit. So under the exemption scheme, it has to incur costs additional to port costs. Let us name these expenses CAPE (Costs Additional To Port Expenses). So the cost incurred by the firm in case it avails exemption under some exemption scheme can be described by following equation.

Cost = 0 due to exemption of duties+ CAP+CAPE

Let us now assume that import duties on the input goods imported by the firm are zero by tariff, then cost will be:

Cost= 0 + CAP+ CAPE (0)

No additional costs shall be involved as the firm is not required to get any licence or quota or analysis card etc.

So the point is that making import duty zero through tariff reduces cost of business for the importing firms compared with import under some exemption scheme as all sorts of duty- exemption regimes require conditionality of using an input good in exported goods by the firm itself, monitoring of its consumption and production, and administrative economic costs. Under zero duty through tariff, the firms can better use their resources and focus on their activities rather than visiting office of the regulator for audit and reconciliation of record of imports, production, and exports.

Simply, policy implication is that special schemes for industries should either be made easy to use especially for SMEs or input goods and machinery exempted through SROs or Fifth Schedule of the Customs Act, 1969 should be shifted to the First schedule of Tariff where all importers, manufacturer or commercial, should have zero or minimal import tariffs without any other import conditions. The input goods imported either by a manufacturer or commercial importer shall finally be used for production of output goods. Same is the case with industrial machinery. It shall be used in manufacturing/ industrial process and it is perhaps not much relevant whether it is imported by the firm itself or through commercial importer. Doing so, simply reduces cost of business for importing firms and shall help entrepreneurs and SMEs grow which may be reluctant to avail exemption schemes due to regulatory burden.

4.5. RevenueThrough Rates and Additional Levies

At least three factors differentiate the tax structures of developing countries from the developed ones (Gordon, 2009). First, the developing countries have large informal sectors which are hard to tax. Second, taxing especially small and medium enterprises may have negative implications for employment and economic growth. Third, capacity of tax machinery is low and low capacity coupled with weak political will makes it difficult to tap the potential of tax revenue especially from sales tax and income tax. Moreover, import tariffs are considered to create fewer distortions compared to VAT type taxes in developing countries due to prevalence of huge informality of businesses (Stiglitz, 2009). WTO also recognises significance of customs duty as a legitimate source of Government revenues. The significance of import stage taxes in a developing country like Pakistan cannot be overemphasised where still about 50 percent revenue is collected from levies at import stage.

Change in tariff rates and additional levies are two important tools used to increase revenue at import stage. For example, in the budget 2014-15, the tariff slab of 30 percent (ceiling) was brought down to 25 percent but floor was raised from 0 percent to 1 percent to compensate for the revenue impact resulting from reduction in ceiling. In the budget 2015-2016, the maximum tariff slab was reduced from 25 percent to 20 percent but the floor was raised from 1 percent to 2 percent. In the budget of FY 2016-17, the tariff slabs of 2 percent and 5 percent were merged into a new slab of 3 percent and the rates of slabs of 10 percent and 15 percent were respectively enhanced to 11 percent and 16 percent. In the budget for the FY 2019-20, slab of 0 percent was again introduced and 1639 tariff lines were subjected to this new slab of 0 percent but rates of additional customs duty were enhanced and scope and coverage of RD increased. ACD and RD constituted around 15 percent part of total CD collection in 2015-16 which increased to 26 percent in 2018-19 (Table XVII).

Table XIV

Increasing Trend of ACD & RD

(Rs. In Million)

Year	Import Value	ACD	RD	CD	Total Duty	ACD in Total Duty (%)	RD in Total Duty (%)	ACD & RD in Total Duty (%)
1	2	3	4	5	6	7	8	9
2015-16	4,658,749	12,858	47,546	344,168	404,572	3.2	11.8	14.93
2016-17	5,539,721	24,150	61,429	411,193	496,772	4.9	12.4	17.23
2017-18	6,694,897	34,302	102,720	471,303	608,325	5.6	16.9	22.52
2018-19	7,499,468	68,823	111,255	503,921	684,000	10.1	16.3	26.33

Source: PRAL/FBR data.

4.6. Effective Rate (ER), Tariff Weighted Average (TWA) and CEF

Is due amount of customs duty, which ought to be collected as per statutory rates, being collected? Let us conduct a brief analysis to answer this question. There are two rates of duty collection. One is effective rate (ER)[25] which is simply total value of imports during a certain period, say month or year divided by amount of custom duty collected during that period. The other rate is tariff weighted average (TWA) which Pritchett and Sethi call 'official rate'. The effective rates of CD can be calculated since 1990s as figures of both 'value of imports' and amount of 'CD collection' are available. TWA of each year is available with WTO and for some years with WITS data repository. TWAs are available since 1997-1998. So I take 1997-98 as base year for my analysis. The TWAs for 2017-18 and 2018-19 are not yet available in WTO data or WITS repository. I assume it should be approximately equal to TWA of 2016-17 i.e.10.90 for said years as well as no substantial changes were made in statutory rates of CD in said years.

The hypothesis is that if there are no leakages of customs duty through misdeclaration i.e. declaring high-duty items in low duty category slabs, evasion and corruption, then ER and TWA should hypothetically be equal. The leakages through smuggling and under- invoicing are not captured in this relationship as quantum of smuggling and under-invoicing are not captured in the official data of Customs. There is marked divergence between ER and TWA. Detailed working is given at Column 2 of Annexure B shows import value reported in Economic Survey of Pakistan. Column 3 and 4 respectively show the amount of ACD and RD. The figures of RD are available since 2007-08 whereas ACD regime is in vogue since 2015-16. Column 6 contains amount of CD collection. For calculating ER column 2 and column 6 are relevant. Column 7 gives ER of CD. Column 9 gives TWAs for different years obtained from WTO record and WITS. Column 10 gives hypothetical value of CD calculated on the basis of TWA, which if no leakages through misdeclaration and corruption had taken place, should have been collected. Column 11 gives difference of CD actually collected and what should have hypothetically been collected in absolute numbers while Column 12 gives the figure of evaded CD in percentage terms.

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[25]ER calculated in three ways. (1) import value/CD collected (2). import value/ CD+ACD+RD collected (3) Dutiable imports/ CD collected.

I take the analysis bit further. There may be concessions and exemptions of CD through SROs and schedules. These concessions and exemptions may be on various accounts like preferential rates of CD due to reciprocity in PTAs or FTAs, concessions to industries through reduced rates or special exemptions of chapter 99. The Economic survey of Pakistan reports cost of exemption (CoE) of CD and other taxes since 2000-2001.Column 13 and 14 give CoE respectively in absolute value and percentage terms. After deducting CoE from hypothetical value not collected (column 11), column 15 gives the hypothetical value of CD which was not collected due to mis-declaration, evasion and corruption at ports. The ER of CD was 17.07 percent in 1997-98 while TWA was 40.69 percent when import tariffs were very high. The unexplained amount of CD in percentage terms was around 138 percent for said year, which means that even half of the due amount of CD was not collected. But as tariff rates went down, CD collection improved which simply means that high tariffs increase burden on businesses and they have high incentive to misdeclare and evade duty and taxes.

The figures of CoE for the years 1997-98 to 1999-2000 are not available in the Economic Survey Pakistan. The TWA is based on statutory rate of CD given in the code. So to ward off bias, it should at best be compared with ER which includes only CD collection based on tariff rates given in the tariff code and should not include ACD and RD. Till the year 2006-07, there is no issue as ACD and RD were not levied. But after said year, the scope of RD and ACD has increased and FBR is reporting collection from all species of customs duties under the head of CD collection. When ER is calculated by including CD,ACD, and RD, it jumps at least two pints on average in the years 2013-14 to 2018-19. So to keep the analysis uniform and simple, I extract out the amount of ACD and RD from the reported collection of CD and use ER calculated on the basis of just CD collection with the TWA. The figures of total CD i.e. CD, ACD, and RD and ER based thereon, as being reported officially, has, however, been mentioned in the tabulated data for the sake of transparency. What does emerge from above analysis?

First, there is no correlation or linear relationship between ER and TWA. In the year 1997-98, ER was in the range of 17 percent. In 2007-08, there is discernible fall in the rate to 5.99 percent . It stays in the range of 5 to 5.5 percent and then witnesses increase in year 2014-15 and exceeds 7 percent with the exception of year 2018-19 when it is 6.72 percent. Second, since 2014-15 a clear reduction in hypothetical unexplained/ evaded amount of CD may be observed which is either due to phasing out of exemptions, or better controls due to automated clearances under WeBOC or combination of both.

I construct another simple matrix called 'collection efficiency factor (CEF)' which is ER divided by TWA. Both the ratios are in percentage terms, so after division we obtain an absolute number Annexure C. Theoretically, its value should range between 0 to 1. In case no CD is collected, both ER and TWA should be zero. Conversely, if there are no leakages through misdeclaration, exemptions (through SROs), evasion and corruption in the CD collection at the ports, ER and TWA should be equal which means what is collected in duties ought to have been ideally collected. Practically, this figure can neither be zero nor one and may attain value somewhere above zero and below one.

Collection Efficiency Factor
(CEF)
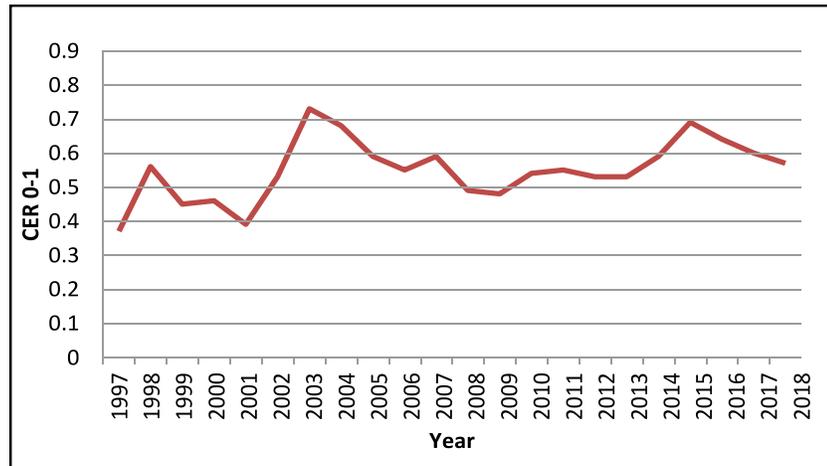
In the year 1997-98, CEF was 0.41 and remains below 0.6 till year 2003. It jumps to 0.77 in 2003-04 and remains above 0.6 till 2007-2008 and then there is fall. In the year 2014-15, CEF again rises, crosses 0.6 and is above that figure till 2018-19. So, since 1997-98 till 2018-19, there are two time intervals i.e.2003-04 to 2007-08 (5 years) and again 2014-15 to 2018-19 (5 years) when CEF witnesses an appreciable increase and consistently remains above 0.6.

What does explain the improvement in CEF in said two periods? Some possible candidates for improvement in CEF may be improvement in customs enforcement due to better monetary incentives[26] or better training of customs officials,[27] or recruitment of new inspectors or appraisers on merit, or enhanced penalties for misdeclaration and evasion and imposition of such penalties religiously, or reforms in Customs for better risk assessment etc. The penalties for misdeclaration etc. did not change much during this period.[28] The incentives for customs inspectors and collectors also did not change substantially and no new recruitments of customs appraisers and inspectors were made during this period. The reforms process was, however, initiated in 1998. The express lane facility was introduced in 1998. In year 2000, the electronic assessment system started assessing duties and taxes on the basis of risk profiling of importers. As part of structural adjustment programme, several reforms were introduced. With few exceptions, customs tariff was brought down from 45 percent in 1998-99 to 25 percent in 2002-02.

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[26]No substantial increase in remuneration was made during this period. Nor any change in the reward structure made. The literature on corruption guides us that small incremental changes in salaries do not help reduce corruption. The salaries need to be increased several times to have an impact on corruption as employees may not indulge in corrupt acts for the fear of losing hefty remuneration/ job which means besides increasing salaries substantially, a strong mechanism of accountability should also be there.

[27]Traditionally, senior management has remained focus of training in Customs. The employees like inspectors and appraisers who do the basic work of inspections and assessment of duty and taxes are hardly the focus of training programmes.

[28]Section 156 of the Customs Act, 1969 prescribes penalties for misdeclaration etc. and there was no substantial change in the penalties for misdeclaration.

Procedural notifications were reviewed and simplified. In year 2001, a single goods declaration (GD) was introduced. In 2002, risk-indicated selective examination started assessing risks in examination procedures and in 2004 automated clearance procedure was introduced. Under PaCCS, one simple electronic declaration was required. Prior to PaCCS, in the manual environment, 26 clearance steps requiring 34 signatures and 62 verifications were involved.[29] These reforms coupled with reduction in tariff rates started showing clear impact on collection of revenue at import stage in 2003-04 and resulted in rise of CEF.

What happened after the year 2007-08? The automated clearance system of PaCCS became controversial. The issues regarding the ownership of its software arose and resistance to reforms started increasing. PaCCS which had been launched as pilot project at Karachi was not rolled out to other customs ports. The risk parameters were not updated/ changed on an ongoing basis, thus enhancing potential of misuse of the system. The reforms process initiated in 1998 had started showing its impact since 2002. Its impact continued till 2007-08 after which CEF again started falling due to slowdown of reform process and change in government.

In 2013-14, WeBOC was rolled out initially covering 60 percent imports but within two years its coverage increased almost to 90 percent. The 2019 Doing Business Report of the World Bank ranked Pakistan at 142 out of 190 economies on indicator for trading across borders. A significant jump on this indicator was primarily due to WeBOC. Now over 90 percent of imports and exports are processed under automated clearance system. Around 80 percent exports and 44 percent imports are cleared under green channel of WeBOC system where no interaction takes place between the customs officials and importers or their agents. Thus improvement in CEF since 2013-14 owes itself to the process of reforms in Customs initiated under the umbrella of WeBOC.

Following points emerge from the above discussion on collection of revenue at import stage. First, as tariff rates go down, revenue from imports increases, so the premise that reduction in tariff rates reduces revenue collection does not hold in the long-run as vindicated by Pakistan's experience of tariff reforms. In 1990s when tariff rates were high, revenue collection was low but as MFN rates deceased, revenue at import stage increased manifold. Second, if tariff rates are high, there is more incentive to evade import duties through under-invoicing, misdeclaration and corruption. In 1997-98, the unexplained hypothetical CD amount not collected was around 138 percent, it was 99 percent in year 2000-2001 and in 2018-19, it is around 46 percent and if compared with ER calculated based on all three species of duties (CD,ACD and RD), the unexplained amount is just 11.8 percent. Third, evasion of import duty through misdeclaration is an important issue to reckon with for which process of reforms in Customs should continue. Improvement in duty collection at ports is directly linked to reforms process and robust risk assessment system.

5. CONCLUSION AND POLICY OPTIONS

The infant industry argument has been peddled with full fanfare in Pakistan. For example, high Protection was given to car assemblers but localisation programme was neither implemented fully by the assemblers nor the government held them accountable for not

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[29]See "Investment Climate in Practice—Reforming Customs Clearance in Pakistan" By Dr. Manzoor Ahmad, World Bank Note No. 59823.

following the said programme. Strategic protection may be required for some sectors but such protection should be time-bound with clear sunset date. A strong accountability mechanism should be in place for protected sectors as protection generates rents, which if not taxed by the government, accentuate distortions in the economy and society.

Pakistan has strong dependency on customs-collected revenue as almost half of FBR's revenue is collected at import stage. Undoubtedly, revenue is administratively easy to collect at ports than inside the country in developing countries like Pakistan due to weak tax culture, huge informal economy, and ineffective tax administration. The high incidence of taxes at import stage, however, has severe negative implications for trade facilitation, business environment, economic growth, and even for revenue itself as due to high incidence of import stage taxes, incentive for under-invoicing, misdeclaration, evasion, and smuggling is high. So there is a case for rationalisation of tariff structure.

The import duties on input goods are low following the cascading principle and number of concessionary/ exemption schemes are also available for import substitution and export promotion. Pakistan has exercised Protectionist policies especially for sectors like textile and auto. Despite all this, economic growth is low and exports are almost stagnant. Where does then lie the problem? The issue lies in details and complexity of the tariff structure and export-oriented schemes. The input goods which are importable @ 0 percent as per tariff code may be subject to other import-stage levies like ACD, RD, ST or WHT. The utilisation rate of export promotion schemes is low especially by small and medium-sized importers, implying thereby that these schemes are not-easy-to-use. So there is need to reduce complexity of the tariff structure and export promotion schemes.

In the medium to short run, Pakistan may not afford drastic reduction in import duties especially for output goods due to balance of payments problems and revenue imperative but in order to put the country on the trajectory of long-term sustainable growth, at least all types of duties and taxes i.e. CD, ACD, RD, Sales Tax and WHT need to be abolished on import of input goods and machinery. Discrimination between commercial importers and manufacturers regarding import of input goods, finally to be used in production of output goods, serves no purpose except the point that doing so makes the availability of input goods difficult for SMEs. The exemption of all types of duties on input goods should be through 'tariff code' and not through difficult-to-use exemption schemes or SROs.

Statutory customs duty is not the only culprit for high burden of taxation at import stage. In the last couple of years, ACD and RD have been applied extensively. There is need to rationalise these duties. They are currently being used as tools of revenue and import compression but may not serve the purpose of long-term growth and even revenue. Reduction/ removal of RD and ACD may not necessarily reduce tariff revenue due to volume effect. There is also need to reduce reliance of inland revenue on import stage. There is at least no justification of colleting income tax at import stage as doing so just creates distortions and disincentives. Furthermore, there is lot of room for enhancing CER and revenue through better enforcement and robust risk assessment. For doing so, more reliance needs to be placed on automated computerised clearance system rather than on physical inspections. The coverage of green channel of WeBOC should gradually be increased. Revenue leakages can be best minimised through simplification of customs procedures and robust risk assessment system.

ANNEXURE-A1

PCT 8703.2199 (Cars & Jeeps 800CC-1000 CC)

	Head	Rate of Duty	Amount (Rs)
A	Import Value US $	US $	5,000
B	Insurance	1%	50
C	Import Value + Insurance		5,050
D	Freight	1%	5.05
E	CIF Value (A+B+D) US $		5,101
F	Import Value in Pak Rupees (@155)		790,578
G	CD	55%	434,818
H	ACD	7%	55,340
I	RD	15%	118,587
J	Value for ST (F+G+H+I)		1,399,322
K	ST	17%	237,885
L	AST	3%	41,980
M	Value for FED (J+K+L)		1,679,187
N	FED	2.5%	41,980
O	Value for WHT (M+N)		1,721,166
P	WHT	12%	206,540
Q	Total duty & taxes		1,137,129
R	Share of import duties in total taxes		54% (approx)
S	Share of other taxes at import stage		46% (approx)
T	Taxes other than import duties on tariff-inclusive price (ST, AST, FED, & WHT)		528,385
U	Other taxes on tariff-exclusive price	34.5% of import value	272,749
V	Difference (T-U)		255,636

ANNEXURE-A2

PCT 6109.1000 (Cotton T Shirt)

	Head	Rate of Duty	Amount(Rs)
A	CIF Value		2,000,000
B	CD	20%	400,000
C	ACD	7%	140,000
D	RD	10%	200,000
E	Value for ST (A+B+C+D)		2,740,000
F	ST	17%	465,800
G	Value for WHT (E+F)		3,205,800
H	WHT	6%	192,348
I	Total duty & taxes (B+C+D+F+H)		1,398,148
J	Share of import duties in total taxes		53% (approx)
K	Share of other taxes at import stage		47% (approx)
L	Taxes other than import duties on tariff-inclusive price (ST, AST, FED, & WHT)		658,148
M	Other taxes on tariff-exclusive price	23% of import value	460,000
N	Difference (L-M)		198,148

ANNEXURE-A3

PCT 6309.0000 Old and Used Clothing

	Head	Rate of Duty	Amount (Rs)
A	CIF Value		930,000
B	CD	3%	27,900
C	ACD	2%	18,600
D	RD	10%	93,000
E	Value for ST (A+B+C+D)		1,069,500
F	ST	17%	181,815
G	Value for WHT (E+F)		1,251,315
H	WHT	6%	75,079
I	Total duty & taxes (B+C+D+F+H)		396,394
J	Share of import duties in total taxes		35% (approx)
K	Share of other taxes at import stage		65% (approx)
L	Taxes other than import duties on tariff-inclusive price (ST, AST, FED, & WHT)		256,894
M	Other taxes on tariff-exclusive price	23% of import value	213,900
N	Difference (L-M)		42,994

ANNEXURE-B

YEAR	Import Value	ACD	RD	CD	Total duty (3+4+5)	ER (CD)	ER (CD+A CD+RD)	TWA	CD in terms of TWA	DIFF. (10-5)	Diff (%)	(CoE)	COE in terms of total duty (6) (%)	Un-explained (11-13)	Un-explained (15) in terms of total duty (6) (%)
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
1997-98	436338	-	-	74496	74496	17.07	17.07	40.69	177546	103050	138				
1998-99	465964	-	-	65292	65292	14.01	14.01	23.13	107777	42485	65				
1999-00	533792	-	-	61659	61659	11.55	11.55	23.12	123413	61754	100				
2000-01	627000	-	-	65047	65047	10.37	10.37	20.62	129287	64240	99	6200	9.5	58040	89.2
2001-02	634630	-	-	47818	47818	7.53	7.53	17.39	110362	62544	131	5422	11.3	57122	119.5
2002-03	714372	-	-	68836	68,836	9.64	9.64	16.71	119372	50536	73	5603	8.1	44933	65.3
2003-04	897825	-	-	91045	91045	10.14	10.14	13.02	116897	25852	28	4397	4.8	21455	23.6
2004-05	1223079	-	-	115374	115374	9.43	9.43	13.00	159000	43626	38	12384	10.7	31242	27.1
2005-06	1711158	-	-	138384	138384	8.09	8.09	12.71	217488	79104	57	33050	23.9	46054	33.3
2006-07	1851806	-	-	132299	132299	7.14	7.14	12.11	224254	91955	70	50520	38.2	41435	31.3
2007-08	2512072	-	203	150460	150663	5.99	6.00	9.50	238647	88187	59	41397	27.5	46790	31.1
2008-09	2723570	-	3361	145042	148403	5.33	5.45	9.88	269089	124047	86	61282	41.3	62765	42.3
2009-10	2910975	-	4002	156271	160273	5.37	5.51	10.20	296919	140648	90	76348	47.6	64300	40.1
2010-11	3455287	-	3912	180941	184853	5.24	5.35	9.02	311667	130726	72	94941	51.4	35785	19.4
2011-12	4009093	-	2706	214200	216906	5.34	5.41	9.02	361620	147420	69	112012	51.6	35408	16.3
2012-13	4349880	-	3678	235781	239459	5.42	5.50	9.41	409324	173542	74	119706	50.0	53836	22.5
2013-14	4630521	-	3756	239055	242811	5.16	5.24	8.92	413042	173988	73	131451	54.1	42537	17.5
2014-15	4644152	-	23632	282588	306220	6.08	6.59	9.58	444910	162322	57	103046	33.7	59276	19.4
2015-16	4658749	12858	47546	344168	404572	7.39	8.68	10.09	470068	125900	37	119993	29.7	5907	1.5
2016-17	5539721	24150	61429	411193	496772	7.42	8.97	10.90	603830	192637	47	151686	30.5	40951	8.2
2017-18	6694897	34302	102720	471303	608325	7.04	9.09	10.90	729744	258441	55	198151	32.6	60290	9.9
2018-19	7499460	68823	111255	503921	684000	6.72	9.12	10.90	817442	313521	62	233134	34.1	80387	11.8

Note:

(a) The import value in column 2 has been taken from various issues of Economic survey of Pakistan.

(b) The figures in colum3 and 4 have been taken from FRB/ PRAL record; FBR officially reports allthe three species of duties i.e. CD, RD and ACD under the head of CD. The rates of ACD and RD are not mentioned in the First schedule of the Customs Act, 1969 (tariff code).The said levies are imposed through SROs. The TWA is based on statutory rates mentioned in the tariff code, so for ER based on CD collection on statutory rates makes the true comparison with TWA. (c)   TWA in column 9 comes from WTO tariff profiles of Pakistan.

(d)   CoE in column 13 is reported in various issues of Economic surveys of Pakistan; Prior to 2000-2001 the cost of exemption has not been reported in Economic Surveys pointing towards low transparency regarding exemptions and rent-se.

ANNEXURE-C

Collection Efficiency Factor

YEAR	Import Value (Rs. In Million)	Effective Rate of CD	TWA*	CEF **
1	2	3	5	6
1997-98	436,338	17.07	40.69	0.42
1998-99	465,964	14.01	23.13	0.61
1999-00	533,792	11.55	23.12	0.50
2000-01	627,000	10.37	20.62	0.50
2001-02	634,630	7.53	17.39	0.43
2002-03	714,372	9.64	16.71	0.58
2003-04	897,825	10.14	13.02	0.78
2004-05	1,223,079	9.43	13.00	0.73
2005-06	1,711,158	8.09	12.71	0.64
2006-07	1,851,806	7.14	12.11	0.59
2007-08	2,512,072	5.99	9.50	0.63
2008-09	2,723,570	5.33	9.88	0.54
2009-10	2,910,975	5.37	10.20	0.53
2010-11	3,455,287	5.24	9.02	0.58
2011-12	4,009,093	5.34	9.02	0.59
2012-13	4,349,880	5.42	9.41	0.58
2013-14	4,630,521	5.16	8.92	0.58
2014-15	4,644,152	6.08	9.58	0.64
2015-16	4,658,749	7.39	10.09	0.73
2016-17	5,539,721	7.42	10.90	0.68
2017-18	6,694,897	7.04	10.90	0.65
2018-19	7,499,468	6.72	10.90	0.62

* TWA= Tariff Weighted Average.
**CEF: Collection Efficiency Factor (Effective Rate / Tariff Weighted Average).

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