

# THE IMPORT SUBSTITUTION POLICY AND STRONG DOMESTIC COMMERCE: CASE STUDY OF MOBILE PHONES<sup>13</sup>



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One of the markets with the fastest-growing rates of cell phone use is Pakistan. The Pakistan Bureau of Statistics (PBS) reports that from USD 28 million in 2019 to USD 2 billion in 2020, the import of cell phones rose by 51%. The Mobile Phone Manufacturing Policy 2020 was created by the Pakistani government in response to the rising demand for cell phones. It offers producers of mobile devices favorable tariffs and non-tariff measures to encourage local manufacturing while addressing their concerns. This case demonstrates the critical importance of balancing import substitution with the development of a strong domestic market. For Pakistan and other emerging economies, it is essential to foster domestic commerce to create a platform for competitive exports. Without this, policies risk becoming mercantilist, trapping industries in low-value production that cannot scale for global success.

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<sup>13</sup>This work is based on PIDE Research on Domestic Commerce: <https://pide.org.pk/research/the-state-of-commerce-in-pakistan-international-domestic/>

By June 2023, 49% localization is the goal established by this policy, with 10% localization in motherboards and batteries included. To support Pakistan in maintaining strong development over an extended period, the policy's primary goals are job creation, import substitution of value-added engineering items, and export diversification and enhancement. If the mobile manufacturing sector barriers are removed, the nation can participate in international value chains.

## HEADLINES

Mobile phone Manufacturing Policy 2020 has failed to achieve its most of targets of localization, bringing in FDI and Export to Africa.

The idea of Import substitution has failed in case of Mobile phone assembling, just like all other Import substitution policies.

## PIDE'S VIEW ON IMPORT SUBSTITUTION POLICY AND DOMESTIC COMMERCE

Both the PIDE Reform Manifesto<sup>14</sup> Economic Policy and the study on domestic commerce, particularly focusing on mobile phone manufacturing, identify serious deficiencies in Pakistan's economic policy, such as excessive reliance on import substitution and over-regulation. The policy for mobile phone manufacturing aimed to promote local production by reducing imports but failed to achieve the goals of localization, export growth, and job creation. This reflects broader structural problems highlighted in the PIDE Reform Manifesto, which criticizes Pakistan's continued dependence on protectionist policies and government interference in the market<sup>15</sup>. In both cases, policies intended to protect domestic industries, such as tariffs on imported goods, fail to foster a competitive and innovative economy. They argue that overly restrictive government policies and regulations create a "permission economy," leading to high costs and significant restrictions on economic activities. Similarly, the study on domestic commerce emphasizes how unnecessary bureaucratic obstacles like no-objection certificates and letters of credit deter both foreign and local investment, limiting innovation and market growth.

Both the Reform Manifesto and the domestic commerce study stress the importance of investment in R&D and creating an environment that fosters innovation.

<sup>14</sup>PIDE Reform Manifesto: <https://pide.org.pk/research/pide-reform-manifesto-transforming-economy-and-society/>

<sup>15</sup>Haque, N.U., Qasim, A.W., & Khawaja, I (2022). PIDE Sludge Audit Volume I. Islamabad: Pakistan Institute of Development Economics Haque, N.U., Qasim, A.W., & Khawaja, I (2022). PIDE Sludge Audit Volume I. Islamabad: Pakistan Institute of Development Economics.

Haque, N.U., Qasim, A.W., & Khan, F.J (2023). PIDE Sludge Audit Volume II. Islamabad: Pakistan Institute of Development Economics.

The Reform Manifesto advocates for replacing outdated policies with a market-oriented economy, embracing international competition, and harnessing national talent through R&D<sup>16</sup>. This is reflected in the mobile phone case study, which shows that without substantial investment in technology and localization of key components, the industry remains stuck in low-value production reliant on imported parts. Both documents also stress the need to learn from international examples like Vietnam, which successfully used trade liberalization, deregulation, and market competitiveness to become a global manufacturing hub. By reducing bureaucratic barriers<sup>17</sup>, promoting innovation, and integrating into global value chains, both the PIDE Reform Manifesto and the domestic commerce study argue that Pakistan can overcome its current economic challenges and unlock its potential for sustained growth.

## **PAKISTAN MOBILE PHONE MANUFACTURING POLICY (PMPMP) 2020: AN ANALYSIS**

### **Key Incentive to Manufacturers**

Completely knocked down (CKD) and semi-knocked down (SKD) kits are subject to a 15% lower import charge by the government than completely built units (CBUs). Consequently, following the 2020 Policy, some 6 million mobile phones were assembled locally utilizing CKDs and SKDs that were imported and registered under the HS Code 8517.7000.

### **Targeted Achievements of PMPP 2020**

The following (Table 1) shows the targets and achievements of the PMMP 2020.

Table.1: Targets Set in Mobile Phone Manufacturing Policy 2020 and Achievements

Category	Target	Achievement
Localization	49% localization target by June 2023, including 10% localization in motherboard and batteries	No parts of the motherboard and batteries are currently being manufactured in Pakistan except for a few casings
Export	Pakistan will export to regional countries such as Central Asian Republics and Africa, UAE,	Exported low-end 16,000 mobiles (i.e., mainly 2G) to the UAE in 2019 & 2020 according to the PTA
Job Creation	Pakistan will create a further 200,000 to half a million jobs	Only 20,000 jobs have been created
Foreign/Local investment	Foreign / Local investment of more than USD 200 million	Total FDI is USD 23.38 million with Samsung having the maximum share of USD 8 million

Source: PMMP 20 and author's analysis

<sup>16</sup>Unrevealing the State of Engineering Industry Phase I (2023). <https://pide.org.pk/research/unraveling-state-of-engineering-industry/>  
<sup>17</sup>Haque, N.U. (2007). Entrepreneurship in Pakistan. Microeconomic Working Papers 22190. Canberra: East Asian Bureau of Economic Research.

## **EVALUATION OF THE POLICY**

The primary flaw in the policy is that it does not offer recommendations to develop an appropriate value chain and research and development (R&D) to satisfy the export and localization goals. Moreover, there is little emphasis on creating an atmosphere that is favorable to international investors to facilitate them. Foreign and local investors must contend with bureaucracy, legal challenges, and sloppiness, including needless no-objection certificates (NOCs) and letters of credit (LCs).

### **IMPORT SUBSTITUTION POLICY**

Import substitution is a policy that aims to reduce a country's reliance on imported goods by encouraging domestic production of substituted goods. It is often used to promote economic development and reduce a country's trade deficit. Pakistan has implemented import substitution policies in various sectors, including mobile manufacturing.

## **Has the import substitution worked?**

Pakistan implemented import substitution policies in several industries, including the production of mobile phones. The effects of these programs have been uneven. In theory, the import substitution strategy may support economic growth, increase employment inside the country, and improve the local economy. The import substitution program has, at best, had a mixed effect on Pakistan. Several businesses, like the car industry, are one example. The auto industry has been given incentives to enable it to create components domestically, but up to now, import substitution has not been accomplished, and the bulk of car parts are imported.

Is the situation different with mobile phones? The following evaluation will give a clearer picture.

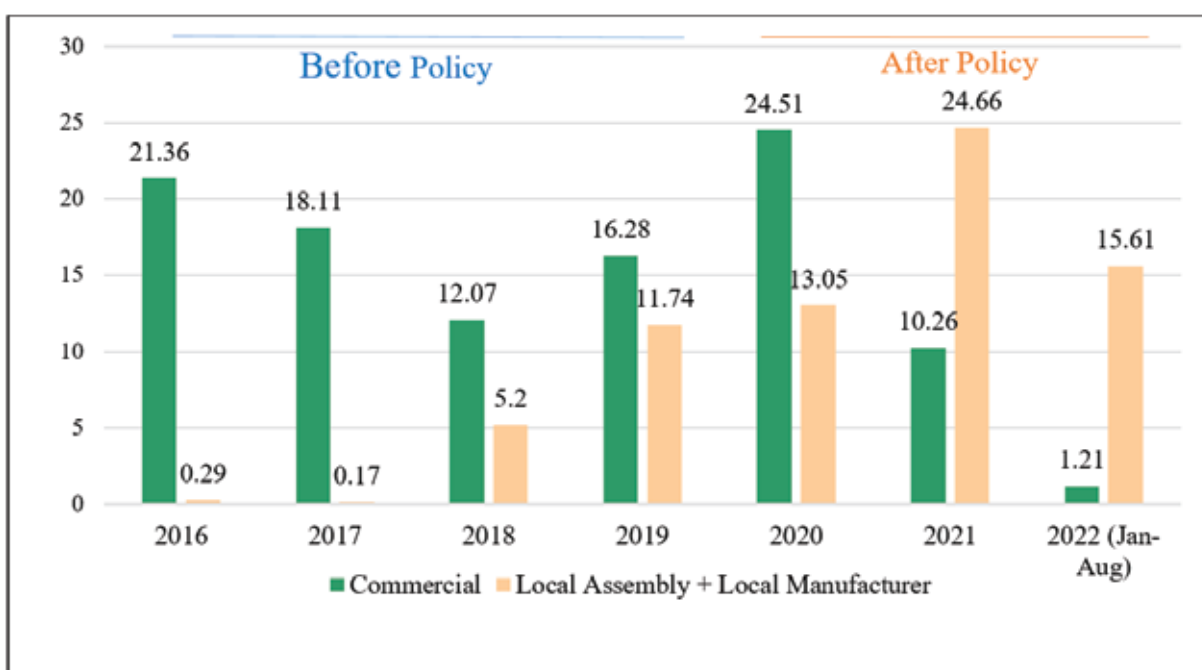
## **Before and after policy analysis of manufacturing**

The telecom industry has benefited from the local mobile manufacturing strategy, which has increased income. As we can see, though, imports of CKDs and SKDs have increased while imports of CBUs have decreased. Prior to the PMMP in 2020, Pakistan was unable to produce mobile phones profitably. But between CBUs and the CKD and SKD parts that the industry imported for manufacture, the government set up a 15% tariff difference. Every month, at least 3 million phones are sold, but because of a policy change in 2020 that

reduced tariffs on the importation of raw materials and CKD or SKD components, about 4 million components and CBUs are imported each month. It encouraged local cell phone production and assembly within a year. Currently, almost all brands that are sold in Pakistan are produced in Pakistan.

According to the data, once the Policy was introduced in 2020, the number of mobile phones assembled increased from 0.29 million units in 2016 to 24.66 million units in 2021. This demonstrates how import substitution has been effective in reducing the import of CBUs while increasing local mobile phone manufacture. Nevertheless, a thorough import and export study helps to further clarify the situation.

Figure 1: Mobile Phone Assembling: Before and After Policy (Millions)

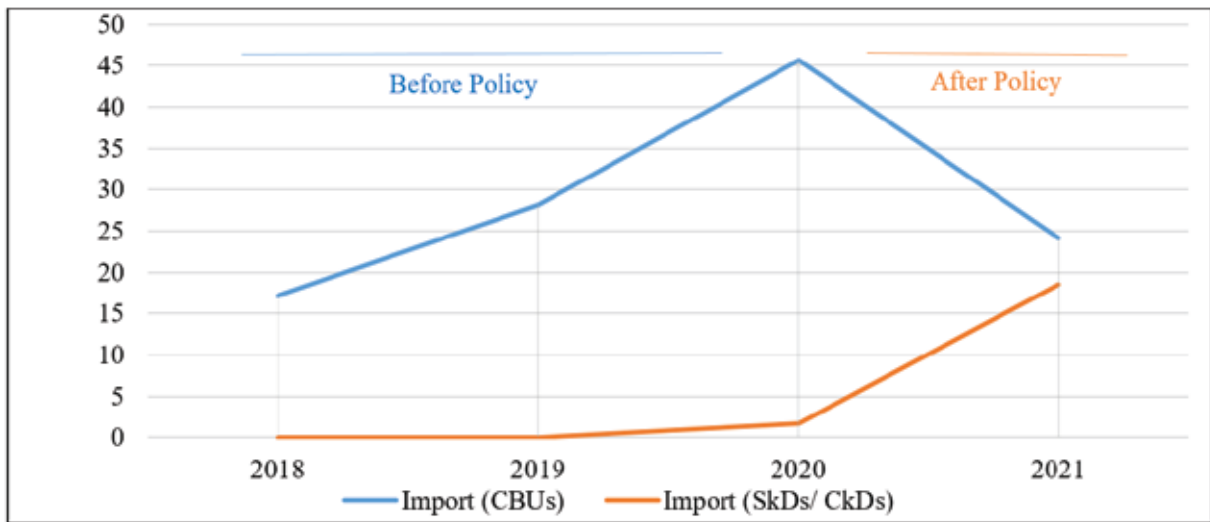


Source: Pakistan Telecommunication Authority

## Imports and import bill before and after Policy

The import of CKD and SKD kits has increased significantly, whereas the import of CBUs has decreased (Figure 1). It suggests that, at least thus far, part localization has not taken place. As a result, the import substitution policy's primary goal—localizing components, which include technology transfer—has not been achieved.

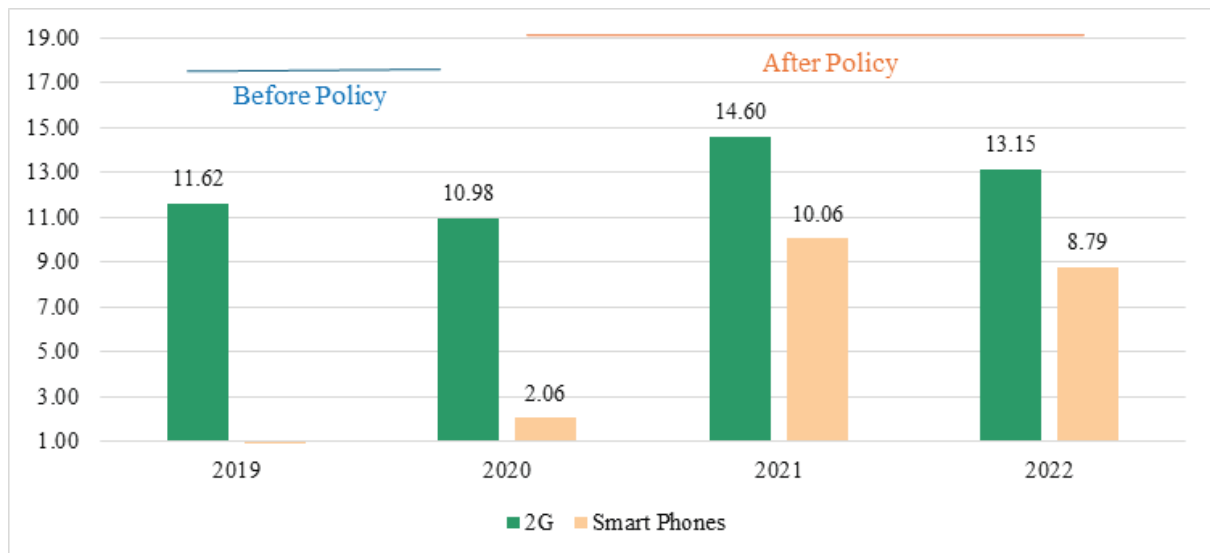
Figure 2: Import Vs. Local Manufacturing: Before and After Policy



Source: Pakistan Telecommunication Authority

As more local mobile phone assemblies have been produced, import substitution appears to be effective, as seen in the prior figure (Figure 1). But following the policy, as shown in (Figure 2), the import of CBUs fell sharply, while the import of CKDs and SKDs increased sharply instead, without being localized in the manufacture of mobile phone parts.

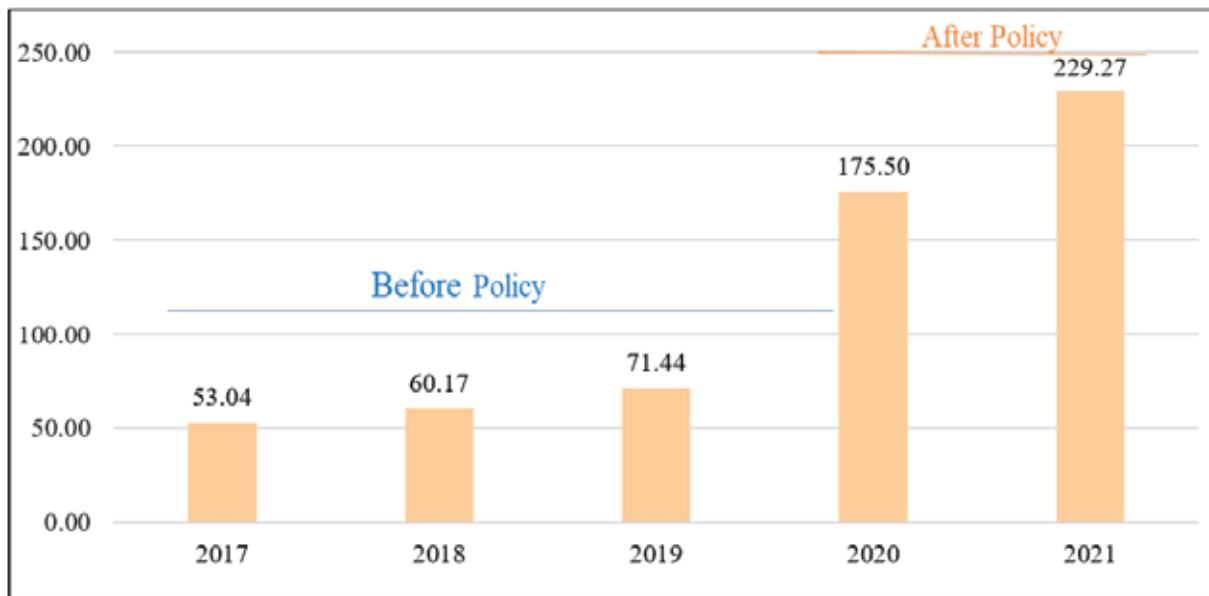
Figure 3: Quality Wise Mobile Assembling: Before and After Policy (Millions)



Source: Pakistan Telecommunication Authority

(Figure 3) illustrates Pakistan's mobile phone assembly quality. 8.79 million smartphones and 13.15 million 2G phones were made in Pakistan in 2022. At now, there is no local manufacturing of mobile parts because of a lack of investment in research and development, localization, and technical patents.

Figure 4: Import Bill: Before and After Policy (USD Million)

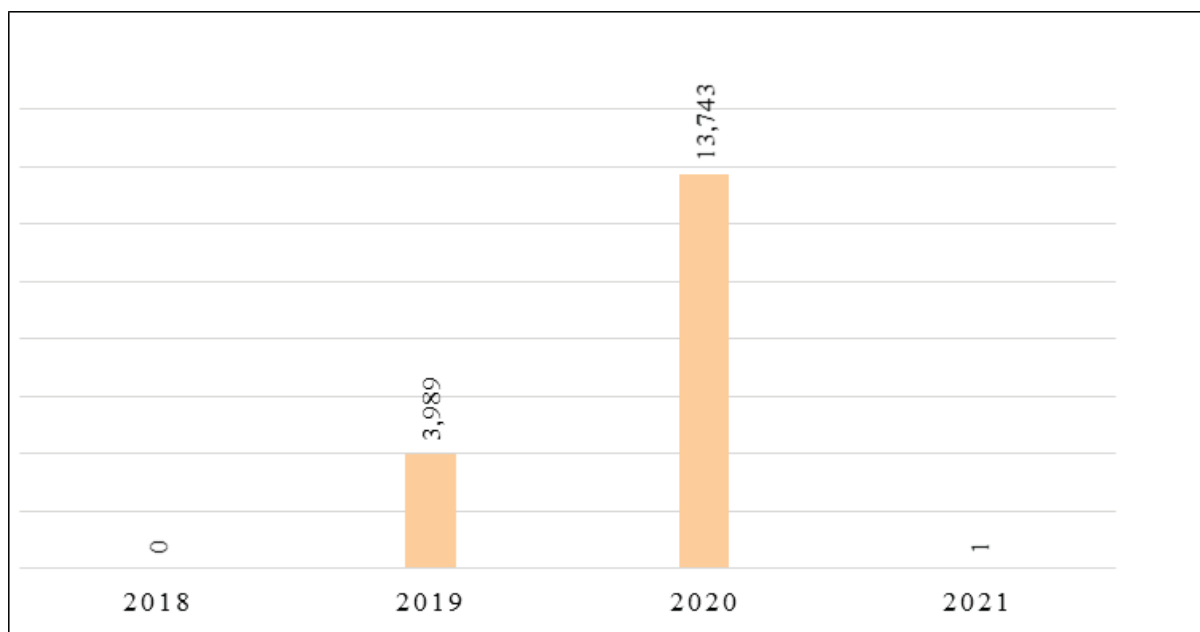


Source: Pakistan Telecommunication Authority

## Exports before and after the Policy

Pakistan only exported a small number of low-end mobile phones to the UAE, as the graph below illustrates. The Mobile Phone Manufacturing Policy 2020 did not, however, set any export goals for the local phone manufacturers in relation to the subsidies. This unrestricted subsidy led to policy failure because it neither increased Pakistan's exports (Figure 4) nor lowered the import bill (Figure 5). This demonstrates that Pakistan's attempt to assemble mobile phones through import substitution, which was the policy's intended goal, has failed.

Figure 5: Exports: Before and After Policy (Units)



Source: Pakistan Telecommunication Authority



## CONCLUSION

The government developed the Mobile Manufacturing Policy 2020, which provides producers a 15% reduced import duty on CKDs and SKDs compared to CBUs, in response to the growing use of mobile phones, particularly smartphones. With the expansion of local mobile phone assembly, it seems that import replacement is working. However, at least for the foreseeable future, no R&D or technical patent suggests that this industry won't localize the mobile phone component in Pakistan. Because trained labor and semiconductors are hard to come by, there is virtually little chance of localization in Integrated Chips (ICs) and batteries, and we are only producing the shells for low-end mobile phones. It seems that the participants in the mobile phone manufacturing space joined the market just to increase their profits because the industry's guaranteed subsidies allow them to make a healthy profit throughout the assembling process. The purpose of an import substitution strategy is to discourage companies from participating in R&D and gaining the necessary technologies in order to fully localize manufacturing. This appears to be their lack of desire.

### **SUCCESS STORY (VIETNAM)**

- one in 10 smartphones is produced in Vietnam - generating more than 65 billion in 2021.
- Why is manufacturing witnessing a renaissance in Vietnam, while relapsing in many parts of the world?
- First, it has embraced trade liberalization - global integration, domestic liberalization
- Second, it has complemented external liberalization with domestic reforms through deregulation
- Third, relentless focus on competitiveness and the ease of doing business.
- Fourth, Vietnam has invested heavily in human dividend and physical capital, predominantly through public investments.
- Finally, Vietnam invested in infrastructure, especially in the power sector and connectivity.

In addition, the majority of the goals are not achieved when we evaluate the policy objectively. By June 2023, for example, this approach was supposed to achieve 49% localization, which included 10% localization of motherboard and battery parts. But except from a few examples, Pakistan has not yet designed or produced a motherboard or batteries. Furthermore, no local production has yet begun. Second, although the target of 500,000 employments has been reached, only 20,000 jobs have been created. Third, the program intends to sell 200,000 mobile phones manufactured in the country to countries such as Central Asian Republics and Afghanistan. Only 16,000 phones were shipped to the UAE, though. Not to mention, the approach aims to lower the price of mobile phones so that local



customers may get less expensive phones. This does not appear to be the case, though, since locally produced mobile phones continue to rely on imported parts, which are expensive to import for a variety of reasons, including the weakening of the local currency. In addition, a comparison is made between the Production Linked Incentive (PLI) Scheme and the Mobile Phone Manufacturing Policy 2020 to show how comparable their designs are. In conclusion, because neither nation had any R&D and both had negative net exports, none was able to significantly contribute to the supply chain.

History and the failure of these policies show that import substitution programs are always counterproductive, driving up costs and reducing customer choice. Furthermore, local industries could not be as productive or competitive as those in other nations, which would lead to a decline in global competitiveness and lower-quality goods.