

REGULATION AND POLICY SPACE



Regulatory Structure

Our Need for a National Tariff Policy

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Pakistan's National Tariff Policy 2019-24 seeks to rationalize tariffs by continuing with some of the past practices such as cascading tariffs; protection of domestic industries and strategic protection. Given that the policy looks to move away from previous policy imperatives, it is important that to the extent possible, these policies are phased out over time. Given that past efforts have had limited success, the NTP should follow the trends prevailing in successful exporting countries.

Over the past several decades, tariffs were often raised to help local producers by artificially raising the prices of imported goods above domestic prices. It was expected that this rise in prices should encourage local production of otherwise imported goods. However, the experience was that these increases in tariffs made the local industry inefficient and unable to compete in the international markets.

The NTP specifically lists three principles which will be kept for the benefit of local industry. Each of these principles and how they can defeat the purpose of tariff reforms is discussed below.

Cascading: While the principle of cascading is important to promote domestic value addition, care must be taken to avoid providing too much protection to downstream industries. Previously, too much protection through cascading was provided to key sectors that failed to grow and stagnated with weak productivity growth because of weak incentives to become competitive.

While the Pakistan Business Council (PBC), in its presentation to the government on Make in Pakistan, proposed cascading tariffs as necessary for reviving the manufacturing sector, this view clearly does not take into account consumer welfare. For this reason, the government should research the efficacy of cascade tax for not just the domestic industry, but also domestic consumers, in keeping with the objectives of the NTP 2019-24. Thus, a cascaded tariff structure is not a panacea for boosting the domestic manufacturing sector. Rather, tariff cascading may

A cascaded tax or tariff ends up being a tax on top of a tax. That being the case, a tariff cascade would have a compound effect, with the final rate being higher than the initial rate charged upstream.

promote rent-seeking, reduce productivity, and hurt consumer welfare by restricting market competition. It is thus important to rethink the imposition of a cascaded tariff structure and introduce a tariff policy that not only supplies the right incentives to producers but also promotes the interests of the consumers.

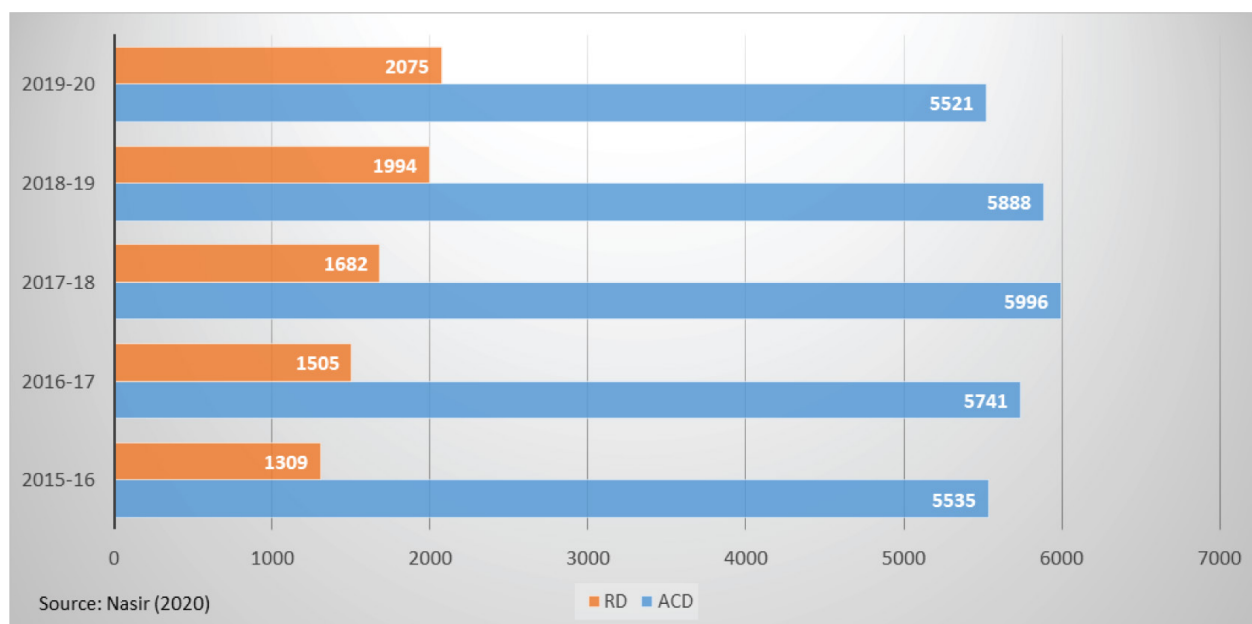
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Quite often cascading creates other anomalies. Often finished product for one industry is a raw material for another. For example, if cascading principle is applied to the raw material of steel sheets and finished machinery, tariff rates on machinery would have to be enhanced. Another example is of paper which currently is subject to high tariffs. In terms of cascading, books made from paper would have to be subjected to even higher tariffs. High tariffs on essential goods such as machinery and books would create serious problems for other sectors. Thus, cascading principle does not work in most of the cases.

PROTECTION FOR IMPORT SUBSTITUTION: The level of protection to import substituting industries need to be properly rationalized to balance the interests

Other countries such as the East Asian Tigers also adopted protectionist measures early in their development, but these measures were for a short predetermined period. In case of Pakistan, once an industry is given protection for a certain period, it is not easy to lower the protection rates. As a result, such industries have remained infant for decades. They could only cater to domestic demand through high tariffs and not be able to export.

of consumers and producers. Tariff reduction will have a benefit for consumers through lower price of imports and access to greater variety at lower prices, and this should be highlighted by the government. If the domestic market continues to be closed to imports by prohibitively high tariffs, it is likely that the tariff jumping investments would create wasteful excess capacity as has happened in the past. Such misallocation of resources hampers productivity and stunts overall economic growth. Pakistan's experience is that whichever industry was given high protection, it never became competitive. Auto. Sugar, Paper industries are some of the examples.



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STRATEGIC PROTECTION: The policy mentions that strategic protection will be provided to domestic industries to protect them from foreign competition. It will be offered to industry in the infancy stage to lower the cost of doing business and is planned to be time-bound and phased out to encourage competition. However, our past performance in this regard is not promising. Industries are still receiving handouts from the government, and timelines are easily revised on some pretext or the other. Unless effectively implemented, this is going to create an added drain on our already limited resources.

It is not clear how domestic industries will be selected for protection. In this context, it is important to spell out at the outset clear guidelines

on how and which industries will be provided strategic protection. Moreover, improving or at the very least maintaining quality must also be a requisite for protection. In the past, such initiatives have merely contributed to rent-seeking while not establishing a strong and competitive industrial sector.

Competitive import substitution is going to be encouraged under the policy, but again the policy document is light on the modalities of how it will all work, not to mention the fact that it becomes hard to justify how the tariff structure is being simplified and prone to less distortions. In the past SROs have been used in addition to tariffs to achieve protectionist goals. How will this work when certain industries are receiving strategic protection while others are receiving help from competitive import substitution, and all are going to be subject to different time bounds?

Various interest groups exert pressure on the government to impose added customs duty (ACD) and regulatory duty (RD) on imports to discourage competition. These duties introduce anomalies in the country's tariff profile, and clearly do not work in the interest of domestic consumers. Instances of these abnormalities have increased in recent years, as evidenced by the increasing number of tariff lines subject to these duties.

Recommendations

- The policy must now be accompanied with a more concrete action plan that puts all on notice on how to go ahead.
- Policy has announced good intentions. But a lot needs to be done to make it happen. We have had tariff liberalization in the past only to be reversed. We should have a clear plan with timelines and a clear transparent immutable information plan.
- Openness is necessary for local competition. Our National Tariff Policy must be synced with our competition policy at home. This is an important exercise that must quickly be started and developed in concrete form.
- Our protection policy has never been clearly enunciated other than to say that it should be temporary. But it has never been as announced. We should now go beyond announcements and actually announce an implementation plan with timelines and with pre-commitment.
- Tax expenditures have not only worsened the fiscal problem but also led to local monopolies at the expense of domestic competition. This must be an important part of the NTP going forward. Tax exemptions should not happen!

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POLICY PROCESS: The new policies of the government focusing on enhancing exports, encouraging foreign investment and Pakistan's integration into the global value chain must all stem from a common holistic view and approach so the most efficient and optimal outcome is achieved.

The Tariff Policy Board will only be successful if the Ministry of Commerce is given the pre-eminent role as has so far been enjoyed by the Ministry of Finance and FBR. Tariff should be set up to promote exports and making Pakistan a part of Global Value Chain. Role of tariff for collection of revenue should be limited as is the case in other successful developing countries.

Finally, there is a need for institutionalizing proper mechanisms for getting feedback from evidence-based policy research. In this context, it is important to include in the tariff policy board (TPB) relevant experts from the academic community and policy think tanks who can provide research-based input into tariff policymaking. Also, inclusion of representatives from the private sector would create stake-holding among the relevant players leading to greater ownership by the market participants.