COST-BENEFIT ANALYSIS OF CONCESSIONARY SROs

By

Kishwer Ali Artas
PIDE2019FMPHIL08

Supervisor
Dr. Ahmad Waqar Qasim

Co-supervisor
Dr. Muhammad Idrees Khawaja

MPhil Public Policy
PIDE School of Social Science
Pakistan Institute of Development Economics, Islamabad
(2022)

Pakistan Institute of Development Economics, Islamabad

PIDE School of Social Sciences

CERTIFICATE

This is to certify that this thesis entitled: **"Cost-Benefit Analysis of Concessionary SROs"** submitted by Kishwer Ali Artas is accepted in its present form by the PIDE School of Social Sciences, Pakistan Institute of Development Economics (PIDE), Islamabad as satisfying the requirements for partial fulfillment of the degree in Master of Philosophy in Public Policy.

Supervisor: Dr. Ahmad Waqar Qasim Signature: _____

Co-Supervisor: Dr. Muhammad Idrees Khawaja Signature: _____

External Examiner: Dr. Jabbar ul Haq Signature: _____

Head,
PIDE School of Social Sciences: Dr. Hafsa Hina Signature: _____

Author's Declaration

I **Kishwer Ali Artas** hereby state that my MPhil thesis titled **Cost-Benefit Analysis of Concessionary SROs** is my work and has not been submitted previously by me for taking any degree from the Pakistan Institute of Development Economics or anywhere else in the country/world.

At any time if my statement is found to be incorrect even after my Graduation the university has the right to withdraw my Ph.D. degree.

Date: 29/04/2022

Signature of Student

Kishwer Ali

Kishwer Ali Artas

Dedication

Dedicated to my beloved parents for their continuous support and prayers.

ACKNOWLEDGEMENTS

In the name of Allah who is the most gracious and merciful, all praise Allah for the completion of my thesis. I would like to express my feelings and gratitude to those who helped me complete this research work. I highly appreciate their sincerity and support.

First of all, I would like to pay my warmest gratitude to my thesis supervisor Dr. Ahmad Waqar Qasim, and co-supervisor Dr. Muhammad Idrees Khawaja for their encouragement and support whenever it was needed. Their assistance, hard work, motivation, and dedication provided me with the way to complete this thesis. I am very thankful to them.

I am very much thankful to my parents for their support and love in the completion of this work.

ABSTRACT

Pakistan's taxation system offers disproportional treatment to different sectors. Some industries benefit from greater protection than others, and some industries are heavily taxed in comparison to others. The automobile industry of Pakistan has always enjoyed protection from foreign and domestic competition through different policy measures like SROs, adopted by the government of Pakistan time and again. The proposed study performs a cost-benefit analysis of those SROs which provide tax concessions and exemptions with a special focus on the automobile sector of Pakistan. There are several costs and benefits associated with SROs; potential costs include distortions in the competitive economic environment, disruption of the level playing field, tax expenditures, rent-seeking, and complexity in the tax regime, while benefits include revenue generation, employment generation, and support, and promotion of domestic industries. To measure and quantify the cost of SROs and associated benefits, the study considered all the concessionary Customs Duty SROs related to the automobile industry of Pakistan issued by the Federal Board of Revenue (FBR) during the last ten years (2010-2020). Data is collected from the World Integrated Tarde Solution (WITS), Federal Board of Revenue (FBR), International Trade Center (ITC), and Organization for Economic Co-operation and Development (OECD). Costs have been calculated in terms of tax expenditures and benefits have been calculated in terms of the net social welfare effect (consumer surplus plus producer surplus). Tax expenditures are calculated as the gap between potential tax revenue, which does not contain tax concessions and exemption, and the realized tax revenue with these concessions while a simulation exercise is performed to calculate the net welfare effects of SROs. This study concluded that the costs of the considered SROs i.e. tax expenditures ($6.683 billion) are much greater than their benefits i.e. social welfare ($8.420 million).

Keywords: SRO, tax expenditure, concessions and exemptions, tariff and custom-duty, automobile sector, social welfare, simulations, SMART.

TABLE OF CONTENTS

LIST OF FIGURES

LIST OF TABLES

LIST OF ABBREVIATIONS

AIDP	Auto Industry Development Policy
CBU	Completely Built-up Unit
CD	Customs duty
CS	Consumer Surplus
EDB	Engineering Development Board
EPR	Effective Protection Rate
FBR	Federal Board of Revenue
GDP	Gross Domestic product
ITC	International Trade Center
MFN	Most Favored Nation
OECD	Economic Co-operation and Development
PS	Producer Surplus
RD	Regulatory Duty
SMART	Simulation and Modeling Assistant for Research and Training
SMEs	Small and Medium Enterprises
SRO	Statutory Regulatory Order
WITS	World Integrated Trade Solution

CHAPTER 1

INTRODUCTION

1.1 Background

Different sectors of Pakistan's economy receive unequal treatment under the country's taxation system. Some industries benefit from greater protection than others, and some industries are heavily taxed in comparison to others. This raises the efficiency concerns of our tax structure and contributes to weakening the taxation system. Ultimately, revenue mobilization has failed to improve over time and the tax-to-GDP ratio remains below potential capacity. One of the reasons for the narrow effective tax base in Pakistan is the widespread prevalence of tax concessions and exemptions. Most concessions and exemptions are offered through; i) enacting laws, ii) schedules attached to the law, and iii) statutory regulatory orders (SROs). For instance, in the case of import duties, the concession and exemption are granted through specific tariff rates for specific products, through chapter 99 of the Customs Act, 1969, and SROs. Such concessions and exemptions complicate the evaluation based on distribution, efficiency, and transparency of the taxation system. The proposed study aims to consider the concessions and exemptions provided through SROs and perform a cost-benefit analysis of these SROs with a special focus on the automobile sector of Pakistan. Amhed and Ather (2014) also link poor revenue generation with a narrow, and ineffective tax base.

The trade policy formulation mechanism in Pakistan is such that the annual budgets provide the overall direction of the policy. All changes in the tariffs are debated in the parliament and the customs tariff schedules update accordingly. Nonetheless, if the government wishes to change the effective tariffs during the fiscal year, then this is done through SROs. The Government has the comprehensive ability to apply tariff exemptions and concessions as well as to introduce or change import restrictions, which are issued by the FBR as Statutory Regulatory Orders (SROs) and authorized by the Cabinet's Economic Coordination Committee. Industry exemptions and partial exemptions under SRO regimes are a major cause of divergence from MFN rates.

Definition of SROs:

The acronym SRO stands for Statutory Regulatory Order and includes all kinds of government instructions and regulations regarding any area and subject carried out by the Federal Board of Revenue (FBR) and/or any concerned ministry (ministry of commerce, ministry of health, etc.) through delegated powers. SROs are executive orders issued to make changes in the existing laws, efficiently implement prevailing laws, and tackle unanticipated events in the economy. In the perspective of taxes, SROs are defined as "the federal and provincial tax laws of Pakistan contain numerous exemptions and concessions while many are added, amended or withdrawn through executive orders, called statutory regulatory orders" (Haq, 2018).

SROs are of two major types in terms of regulations – procedural and concessionary. Concessionary SROs are used for providing tax concessions and exemptions as well as for imposing extra taxes in the form of ACDs and RDs while Procedural SROs provide rules or procedures to carry out existing tax laws.

History of SROs:

The practice of issuing SROs is rooted back in the indigenization program that started in 1988. The program aimed to increase the local content share in the production, especially in automobile and engineering products. Firms that participated in the program were allowed to import specific inputs on concessionary tariffs through SROs. The basic objective of this practice was to extend protection to the local industry by reducing the import cost of non-locally produced inputs and imposing higher tariffs on final products. SROs have been used more frequently since 2006, many of these SROs grant full or partial exemptions from standard duties while others impose higher tariffs. More than half of all tariff lines (54 percent) were subject to at least one special condition published in an SRO in 2010/11. The majority of these are input exemptions that are limited to certain firms or groups of firms. Other importers, particularly commercial importers, do not have access to them. However, the recent practice of issuing SROs mostly revolves around industries instead of individual units.

Objectives of SROs:

The ministry of finance of Pakistan specifies four main objectives for the provision of the SROs in general; i) provide relief to the public, ii) support local industry by reducing duties on inputs, iii) increase the competitiveness of the export sector, iv) gain benefits of trade through FTA/PTA with major trading partners. The evolution of SROs culture over time also incorporates the practice of issuing SROs which are procedural. However, here we focus only on concessionary SROs and more specifically SROs related to customs duties

Custom duty and SROs:

Customs Duty is a tax imposed on the import and export of goods in Pakistan. In addition to protecting the domestic industries from foreign competition, the CD is one of the main sources of government revenue. Customs Duty in Pakistan is defined under the Customs Act,1969. The Pakistan Customs Tariff is based on the Harmonized Commodity Description and Coding System (HS) 2017, which has 21 sections and 97 chapters, and 7356 tariff lines. Services (federal excise rates) are covered in Chapter 98, while specific categorization provisions are covered in Chapter 99. After the introduction of the zero percent tariff slab in 2019-2020, at present, there are five slabs under the current tariff structure: 0%, 3%, 11%, 16%, and 20%. CD rates of 30% and more are mainly reserved for the car industry and alcoholic beverages. Above one-third of tariff lines fall between the 0% and 3% slabs, while one-third of tariff lines are under the 20% slab.

The basic objective of tariff or customs duty in Pakistan has remained import substitution, export promotion, and revenue generation which is achieved through high tariff rates on final goods and a reduced rate or exemption on input goods and raw materials. The present structure of CDs is expensive for government revenue because it protects finished goods with higher tariff rates and input products with zero or very low tariff rates. Government revenue is decreased by the amount of customs duty lost on imported inputs and the replaced imports. Furthermore, high output tariffs and a high effective rate of protection promote smuggling of those products leading to additional loss of government revenue. In addition to CDs, Regulatory duties (RDs) were introduced in 2008 to help the economy to deal with the balance of payment issues that were raised due to the Global Financial Crisis (GFC),2008. RDs were mostly imposed on luxurious items to reduce their import and at the same time to increase government revenue

Under the Customs Act,1969, imported goods are provided tariff concessions and exemptions through three different means: first, Through special classification in chapter 99 Pakistan Customs Tariff published each year by FBR, second, Through specific tariff rates, and third, through Statutory Regulatory Orders. SROs pertaining to customs duty are issued under Section 19 of the Customs Act (1969), which allows the Federal Government to exempt all or part of the customs tax liability on imported products. The type and form of SRO concessions have changed through time, and the taxation system is now moving away from individual SROs toward Schedules, where the same SROs are introduced through schedules such as the 5th Schedule of the Customs Act and the 6th Schedule of the Sales Tax Act, 1990. Although the number of SROs has been reducing since 2013-2014 they are present under different schedules with the same purpose and objectives.

SROs Complicate Trade Policy:

The scheme of SROs has complicated the tariff structure of Pakistan. These are issued separately and do not impact or modify the general CD rates, many of which are limited to specific users of the products, resulting in two separate tariff rates for the same product (normal tariff and SRO tariff). Due to these SROs and schedules, there are three different tariff rates namely the general/normal tariff rate, the schedule tariff rate, and the SRO tariff rate. In some SROs import tariffs have been increased by the imposition of regulatory duties (RDs), except for countries that are part of Free Trade agreements (FTAs) and Partial Trade Agreements (PTAs). Therefore, the imports from these countries have been further protected under the umbrella of RD. In many developing countries, including Pakistan, the imposition of extra taxes in the form of RDs and ACDs mainly benefits monopolies and oligopolies of intermediate goods. This hurts most small businesses and firms that use these products. The presence of hundreds of SROs in Customs (tariff slabs with a maximum value of 20% and minimum value of 2%) creates difficulty and leakages in the collection of tariffs and promotes smuggling, under-invoicing, and distortions. A uniform tariff rate of 5% for all items will remove these illnesses from customs (Haq, 2018).

The Rationale of SROs as per Government Claim:

According to the Ministry of Finance, SRO-based exemptions are permissible under government policy and therefore are provided to facilitate particular industries (by reducing their manufacturing costs), provide relief to the general public (e.g. exemptions on imports of wheat,

medicines, etc.), attract foreign direct investment, enhance the competitiveness of the export sector, and provide tax benefits to taxpayers in extraordinary circumstances and to acquire trade gains from major trading allies through free/preferential trade agreements.

The Indian Case:

The current SRO system in Pakistan can be compared with India's import licensing system which heavily regulated India's automotive sector until the 1970s and by the 1990s this system was finally abolished. By abolishing the import licensing system India removed import licensing from capital equipment and intermediate goods and adopted the policy of import liberalization and export promotion. Liberalization policy played a major role in transforming the Indian economy towards a speedy growth in production, exports, and a heavy inflow of FDI during the 2000s. presently, Indian car exports are four times more than Pakistan's total car production and India is the world's largest producer of two-wheelers, three-wheelers, and tractors. In 2020, India was the 5th largest auto market with approximately 3.49 million units combined sold in the passenger and commercial vehicle categories.

The evolution of India's automotive industry is identified to have occurred in four phases. In the first (1947-1965) and the second phase (1966-1979), the important policies identified were related to the protection, indigenization, and regulation of the industry. On the one hand, these policies helped India to build an indigenous automotive industry, while on the other it led to unsatisfactory industry performance. In the third phase (1980-1990), the single most important policy identified was the one about relaxation in the means of technology acquisition. The foreign competition inducted into the industry transformed its dynamics. Lastly, in the fourth phase (1991 onwards) the liberalization concerning foreign investment had a significant influence on the Indian automotive industry as we see it today. Additionally, supporting policy measures of the Indian government such as export-linked fiscal incentives, establishment of export-processing zones, bilateral or multilateral trade agreements with other countries, etc. have furthered this growth. The automobile industry in India comprises a good balance of domestic as well as foreign players. The export performance of the automotive industry between the years 1951 and 1980 had been mediocre. Being a net user of foreign exchange, the automotive industry was given much attention for improving its export performance. Accordingly, various export promotion measures were

implemented by the government. As a consequence, the export of the Indian automotive industry nearly doubled from INR 1561 million in 1984-85 to INR 3041 million in 1988-89. Overall automobile exports reached 4.77 million vehicles in the FY20 growing at a CAGR of 6.94% during 20162020 However, in Pakistan, indigenization and protectionist policies still exist contributing to the poor performance of the industry in terms of growth, quality, and exports.

1.2 Evaluation of SROs – Comparison of Costs and Benefits

At times SROs can be beneficial or harmful for the trade market, businesses, economy, and society. To begin with, SROs create large fiscal costs and tax expenditures; the actual revenue collected by FBR with these concessions and exemptions is lower than the total revenues that can be collected without these exemptions and concessions. In the year 2018, around 2,000 tariff lines were under SRO-based tariff concessions with import duties of less than 5.1%, and nearly 900 of them were given full exemptions (zero-rated). Amhed and Ather (2014) estimated aggregate customs-related tax expenditure for these concessions and exemptions as around Rs.128 billion for 2011-12. Second, SROs are often assumed to be the product of the privileged class and lobbying and are intended for rent-seeking; most powerful lobbies use SROs to get complete or partial exemptions from taxes and duties. For example, in Pakistan, the auto sector is protected by several SROs (for example, SRO 656(I)/2006, SRO 1402(I)2012, SRO 607(I)2015, etc.), making it difficult for international competitors to enter the market. Tax and tariff concessions in the form of SROs especially to the rich and mighty section of the society further increase the fiscal deficit and public debt and it is one of the main reasons for the narrow tax base in Pakistan. Resultantly, the beneficiaries of these concessions are usually small groups, while costs are usually dispersed among all taxpayers. In some SROs import tariffs have been increased by the imposition of regulatory duties (RDs), except for countries that are part of Free Trade agreements (FTAs) and Partial Trade Agreements (PTAs), thereby, further protecting the imports from these countries under the umbrella of RD. In many developing countries, including Pakistan, the imposition of extra taxes in the form of RDs and ACDs mainly benefits monopolies and oligopolies of intermediate goods. Pursell *et al.* (2011) have pointed out that around 91% of 1006 locally produced products listed by the Engineering Development Board (EDB) are manufactured by a single producer in Pakistan. Third, the scheme of SROs has complicated the tariff structure of Pakistan. These are issued separately and do not impact or modify general CD rates, many of which

are limited to specific users of the products, resulting in two separate tariff rates for the same product (normal tariff and SRO tariff). The extent to which new exemptions and concessions extend, substitute, or duplicate earlier ones, and the number of amendments made to some of these SROs are often unclear, individual SROs make it difficult to determine the taxes and other measures that apply to individual tariff products that may be covered by many SROs. The presence of hundreds of SROs in Customs (tariff slabs with a maximum value of 20% and minimum value of 2%) creates difficulty and leakages in the collection of tariffs and also promotes smuggling, under-invoicing, and distortions. Fourth, SROs create bias against SMEs because SROs are issued with specific conditions attached to them that SMEs cannot fulfill so they prefer to buy from commercial importers which import them at MFN rates because concessions offered by SROs are not for commercial importers, which are crucial to cater to the demand of SMEs. Thus, the large firms in the sector enjoy greater market power after these concessions. Fifth, SROs discourage economic activities by killing the level playing field in the form of higher tariffs and duties for one sector and at the same time giving favors in the form of tariff concessions to other sectors. For example, in Pakistan, imported inputs used in the automotive sector are mostly exempted from import duties, and at the same time, their outputs are protected with higher import duties on the import of completely Built-up Units (CBUs).

In summary, the SRO culture obstructs the development process of the country in the long run due to policy capture by the elite class, imposes a fiscal burden, and impedes innovation (PIDE,2016).

On the other hand, SROs are also beneficial as they have been used to generate additional revenue to reduce fiscal costs through regulatory duties and additional Customs duties at the import stage. In addition to CDs, Regulatory duties (RDs) were introduced in 2008 to help the economy to deal with the balance of payment issues that were raised due to the Global Financial Crisis (GFC),2008. RDs were mostly imposed on luxurious items to reduce their import and at the same time to increase government revenue. Secondly, SROs have provided conditional exemptions for those sectors which needed them to grow their businesses like the automobile sector during its initial stages was protected under tariff concessions and exemptions under various SROs. Thirdly, SROs promote new sectors. Since the tariff rates in Pakistan are very high so concessions in the form of SROs to new sectors and economic activities help them grow and compete with their foreign and domestic competitors. Three SROs (SRO 656(I)/2006, SRO 655(I)/2006, and SRO 693(I)/2006,),

accounting for 23 percent of Pakistan's imports in 2009-10 provided the most important exemptions for the industrial sector. Companies or sectors that fell within these three SRO clauses, on average, obtained reductions of up to 11 percentage points from the statutory rates, which were implemented in a non-uniform manner among industries (Secretariat, 2015). Finally, apart from concessionary SROs, there are other SROs that have been issued to tackle unanticipated events in the country to ensure safety and security reasons. The Ministry of Commerce, the Government of Pakistan, notifies and regulates the export and import of commodities from any of the countries through SROs owing to policy, safety, security, and environmental reasons. For example, SRO 526(I)2020 was issued by MOC during the Covid-19 pandemic to impose a ban on the export of some PPEs like N-95 masks and surgical masks which was the right step taken at the right time to meet domestic demand for PPEs (Zia & Mehmood, 2020).

1.3 Defining Tax Expenditures

Around the globe as well as in Pakistan, there is no legal or formal definition of what constitutes a tax expenditure. Different countries define tax expenditures differently but generally, a tax expenditure is a gap between the potential tax revenue that does not contain tax concessions and exemptions, and the tax revenue received in the presence of tax concessions. In Pakistan, a Tax expenditure is defined as "the loss of tax revenue resulting from preferential provisions of the tax laws that offer specified taxpayers/classes of taxpayers or some specific industries/sectors with concessions that are not accessible to other taxpayers or sectors, resulting in the collection of less tax revenue than would otherwise be the case"(Amhed & Ather, 2014). Tax expenditure accounting analysis is important from two perspectives: first, it identifies potential areas for additional revenue generation; and second, it provides further information about the government's actual budget expenditures that are not reflected in the budget documents' spending programs. Tax expenditures under customs occur due to Exemptions and partial exemptions on customs duties which are provided through special classification in chapter 99 of the Customs Act, through specific tariff rates, and Statutory Regulatory Orders (SROs). These Exemptions and concessions are given on assembly and manufacturing of vehicles, on plant, equipment & machinery, components, and sub-components, on raw materials manufactured locally and raw materials not manufactured locally, on assemblies and sub-assemblies, Concessions to privileged persons and individual organizations, and Concessional arrangements under various bilateral and Regional

Agreements. During the fiscal year 2013-14, the cost of exemptions and concessions as a result of import-related SROs was Rs 137 billion (Secretariat, 2015).

1.4 Problem Statement

SROs discourage the economic environment and competitiveness by killing the level playing field by imposing extra taxes and duties on some sectors while at the same time offering tax concessions to selected industries, firms, or sectors. The issuance of SROs is a revenue loss for the government because of those tax concessions the government cannot collect its potential level of revenues.

1.5 Significance of the Study

Though SRO culture was introduced in the ’90s, very little literature exists on this topic because it is still under research in Pakistan. There is a need for good research to explore more about SRO culture in Pakistan. This study will provide in-depth knowledge of SROs regarding their economic costs and benefits and will estimate the benefits and losses generated by these SROs

1.6 Research Questions

The major prominence of this study is to find out and calculate the various costs and benefits occurring due to the provision of these SROs. For this purpose, this study has constructed the following research questions:

1. What are the economic costs and benefits of concessionary SROs?
2. What are the impacts of the concessionary regime on import substitution, export competitiveness, industrial growth, and government revenue?

1.7 Research Objective

The main purpose of this study is to analyze and evaluate the cost and benefits of the SRO scheme by focusing on concessionary Customs Duty SROs provided to the Automobile industry of Pakistan between 2010 to 2020. The major objective of this study is:

- To Calculate the Costs and benefits of various SRO-based concessions and exemptions provided to the automobile sector of Pakistan. Costs can be calculated in terms of tax

expenditures and benefits can be calculated in terms of consumer surplus and producer surplus.

1.8 Thesis Structure

The first chapter explains the introduction/background, problem statement, research questions, research objective, and significance of the study. The second chapter comprises two parts; a literature review and an overview of the automobile sector of Pakistan. The third chapter contains data and methodology. The fourth chapter discusses the results and findings. The fifth chapter includes the conclusion and recommendations and the sixth chapter consists of the qualitative part.

CHAPTER 2

LITERATURE REVIEW & OVERVIEW OF THE AUTOMOBILE INDUSTRY

2.1 Literature Review

Although the scheme of SROs was introduced in the 1990s, one cannot find sufficient literature or empirical work in this area. The present study did not find previous literature or empirical work on the comparison of costs and benefits of concessionary SROs that either SROs costs outweigh their benefits or vice versa. However, there are a few studies that have estimated the costs of concessions given under various SROs, schedules, and special classifications in the tax laws. These studies have estimated the costs of SROs in terms of tax expenditure and benefits in terms of welfare generation. One such study performed by Amhed and Ather (2014) provides a comprehensive estimation of tax expenditures in Pakistan for the fiscal Year 2011-2012. The year 2011- 2012 was chosen because of the availability of complete annual data on tax collections. This study defined tax expenditures as, "the loss of tax revenue resulting from preferential provisions of the tax law that offer specified taxpayers/classes of taxpayers or some specific industries/sectors with concessions that are not accessible to other taxpayers or sectors, resulting in the collection of less tax revenue than would be collected under the basic tax structure". The tax expenditure estimates for the three major taxes – sales tax, income tax, and customs duties, were calculated separately and provided to each potential sector and segment for the chosen year by using the revenue forgone method. In this method, total payable taxes are calculated in the absence of these tax concessions.

Results indicate that for income tax, the tax expenditure on refundable allowances and exempted income sources for persons and the Association of persons amounted to Rs.73.97 billion. Tax expenditures on three sources of income; imports, dividends, and contracts are estimated to be Rs.52.05 billion. Due to a lack of disaggregated data, these estimates are derived directly from the taxpayers' aggregate declarations using a tax rate of 15% for individuals/AOP and 30% for businesses. The cost of exemptions given to IT services comes to around Rs.3.72 billion. For the Estimation of tax expenditure caused due to sales tax concessions, separate calculations were

performed for GST at the import stage and GST at the domestic level. GST at the import stage is done through Goods Declaration data while estimates of domestic sales tax are based on the Input-Output model table of 1989-1990 updated for 2011-2012. Results show that the overall tax expenditure for Domestic Sales Tax is around Rs.171.9 billion, while SRO-based estimates of tax expenditure are Rs 58.40 billion, and tax expenditure for seven major services which are not yet in the sales tax net is estimated to be Rs.82.5 billion. The tax expenditures under Customs have been calculated using the Goods Declaration data which comes out to be Rs.128 billion which indicates that almost 60% of the imports into Pakistan are either tariff-free or have been provided preferential tariff rates under various SROs. The total expenditure occurring under Sales tax, Income tax, and Customs duties is Rs511.4 billion for the fiscal year 2011-2012. This study did not provide all the estimates of tax expenditure due to data limitations and the methodological approach used.

A study conducted by Pasha and Pasha (2015) on Pakistan's tax system also provided a comprehensive study on tax expenditures defined as "the revenue losses due to concessions and exemptions in the tax code" and estimated the magnitude of tax expenditures for both federal and provincial levels. According to the Pakistan Economic Survey 2011-2012, the official estimate of tax expenditures incurred under federal taxes was PRs 186 billion, the largest share being contributed by custom duties and secondly by income tax while the estimates of this study showed a total tax expenditure of PRs 550 billion in 2010-11. Tax expenditures for income tax, sales tax, and customs duties have been estimated separately. For income tax; tax expenditures that occurred due to exemptions on capital gain are PRs 22 billion, a 30-year tax holiday for independent power producers accrued PRs 12 billion as tax expenditures, tax deductions on loans provisioning by commercial banks caused PRs 9 billion revenue loss, tax deduction on charitable contributions are PRs 2 billion, the exemption of export income from services cost PRs 1 billion and others PRs 28 billion as tax expenditures. Tax expenditures on sales tax are PRs 64 billion due to exemption of various goods from sales tax plus PRs 21 billion for zero-rating of domestic sales of export-oriented sectors such as textile and leather. Total tax expenditure on the exemption of sales tax is PRs 70 billion excluding services mentioned in the second schedule of the Sales Tax on Services Act. The estimations of Customs duty tax expenditures based on zero duty on POL, fertilizers, and cotton is PRs 44 billion, costs of exemptions in SROs especially SRO 567(I)2006, 565(I)2006, 575(I)2006 is PRs 80 billion; preferential rate of duty in trade agreements, especially with china

caused worth PRs 12 billion revues lost. Excise duty tax expenditures worth PRs 11 billion includes exemptions on luxurious goods such as larger automobile, freezers, air conditioners, perfumes, and cosmetic. Provincial taxes which include agriculture income tax showed a tax expenditure of PRs 50 billion occurred due to low presumptive rates of taxation and PRs 30 billion due to preferential treatment of owner-occupied properties and lack of extension of rating areas. Tax exemptions on capital gains on properties contributed to PRs 15 billion. From their analysis and estimations of tax expenditures, this study concluded that tax exemptions and concessions for indirect taxes account for a tax expenditure of PRs 260 billion which is equivalent to 46 percent of the total. It can be inferred from this result that tax exemptions in Pakistan benefit the rich and powerful segments.

One of the major sources of government revenue is custom duties but protection to local producers in the form of higher tariffs on output or finished goods and concessions and exemptions on input goods or raw materials highly reduces government revenues received. This combination of output and input tariffs is intended to encourage the substitution of local industry for imported goods; as a result, a significant amount of Customs income is lost on the substituted imports. During 2008/09, the overall reduction in CD collected under the "Survey-based" concessions (SRO 565(I)/2006) was 2.839 billion rupees or around 1.9 percent of total Customs Duty collection. In 2008/09, the entire amount of "non-survey based" exclusions (SRO567 (I)/2006) was 18.12 billion rupees or around 12.2 percent of total CD revenue.

Pursell, Khan, and Gulzar (2011) performed a study on “Pakistan’s Trade Policies” specifically focusing on the level and structure of import tariffs and trade policies that affect the auto, textile, and clothing sectors. This study also defined the roles of SROs and has carried out a detailed analysis. The study found that the basic purpose of this concessionary system was to provide extra protection to the processing margins of local producers by decreasing their costs of production through lower duties on input material. Due to these SROs, Effective protection rates (EPRs) are highly dispersed across different industries varying from 100% for some sectors to zero or negative for other sectors. In addition, the reductions for most of the inputs covered in SROs 565(I) 2006 and 567(I) 2006 are exclusively available to manufacturers; commercial importers would have to pay the full statutory tariff rate. This discriminatory treatment may exclude commercial imports because the system forces small and medium manufacturers to engage in importing thus increasing

importing expenses and giving market power to the generally larger enterprises completely which can cause several serious economic costs. Finally, the management of this system of SROs which acts more like an import licensing system causes translation costs both for the firms that hope to benefit and for the government bodies that administer it. Because of these transaction costs, the value of these concessions to firms (especially small and medium) decreases but this system benefits large established firms because their transaction costs are lower compared to their output. The study suggested that there must be a limit on the quantities of products imported at the low exempted Custom duties (CD) or else without any limit, the statutory CD would be replaced by the low preferential CD and it would become the de facto general customs duty.

In the context of taxation, SROs modify tax codes by increasing or decreasing the normal tax and tariff rates. Concessional SROs (only concessions) have costs that can be evaluated in terms of lost government tax income (tax expenditures). Although there are several studies (as mentioned in the above paragraphs) that provide costs of SROs, this study did not find single empirical literature that directly mentions and estimates the profits of SROs. since SROs are nothing but tax concessions and exemptions so their benefits can be measured in terms of benefits occurring due to tax and tariffs concessions/exemption. Several studies have provided the welfare impact of tariff and tax reductions. One such study conducted by Siddiqui, Iqbal, and Kazmi (1999) analyzed the impact of tariff reduction on the functional income distribution using the CGE (Computable General Equilibrium Technique) technique. Simulations were performed to show the effect of an 80% tariff rate reduction on industrial imports. The results of simulations display the influence of tariff reduction on household income through changes in factor prices. Results showed that due to the reduction in factor prices household's real income has increased and the percentage share of labor in GDP has also improved while the percentage share of capital has reduced in the national income. Since a higher portion of the income from capital is accrued to the wealthy class of the society while a higher percentage of income in the form of salaries and wages goes to the poor. The results of tariff reduction indicated an overall welfare-enhancing impact on households by reducing the gap between the poor and rich sections of the population.

Ahmed, Khan, and Afzal (2015) observed how trade liberalization affects industrial productivity in the case of Pakistan by estimating the impact of trade liberalization on total factor productivity (TFP) and the impact of an Effective Protection Rate (EPR). For this purpose, they used twenty-

seven 3-digit manufacturing industries including Machinery and Transport Equipment Manufacturers for the period 1980 to 2006. This study took Excise duty as a proxy for trade liberalization. Their findings indicated that output elasticities concerning capital, labor, and raw materials are positive for both eras (pre-trade liberalization and post-trade liberalization). Secondly, results indicated the positive but very small impact of excise duty on TFP in both the pre and post-liberalization phases. Furthermore, results show that a decrease in ERP exerts a positive impact on TFP but its magnitude in the pre-liberalization period is very small (-0.008) as compared to the post-liberalization era (-0.02).

It is generally believed that trade liberalization and reduction in tariff rate would generate social welfare and sustainable economic growth because it offers competitive prices and quality products to the consumers and reduce producers' input costs, and provides them easy access to modern technology. Hanh (2019) explored the impacts of EVFTA (European-Vietnam Free Trade Agreement) on the Vietnamese economy. The study designed a Social Accounting Matrix (SAM) based on Vietnam's input-output table for the year 2012 and employed the CGE model to simulate various economic scenarios by reducing tariff rates to zero in Vietnam's industrial sector. Results showed that tariff reduction improves social welfare, and supports the entire economy in terms of growth in household consumption, trade value, and growth in factors of production. Results of the simulation exercise showed a 9.13% increase in household consumption due to the removal of tariffs in the industrial sector. However, the elimination of tariffs caused trade deficits due to a high rate of increase in imports (12.54%) as compared to exports which increased by 2.71 percent.

Even though the SRO system was adopted in the 1990s, there is a lack of literature and empirical work on this topic. The existing relevant literature on SROs Amhed and Ather (2014), and Pasha and Pasha (2015) discuss and calculates tax expenditures on the aggregate level, their objective is not to highlight issues of a particular sector/industry. This study is more relevant to Pursell *et al.* (2011) study but Pursell performed a study on Pakistan's Trade Policies by taking the automobile industry as a case study and have considered and estimated tax expenditures (costs) of only 3 SROs of the auto sector while our study focuses on the whole automobile industry of Pakistan and considers all the concessionary customs duty SROs issued for this sector during 2010 to 2020. The main reason for selecting this sector for the current analysis is that this sector has always been given protection (in the form of tax reliefs) from foreign and domestic competition through

different policy measures like SROs. There has been no study in Pakistan that has examined and analyzed the costs and advantages of SROs offered to Pakistan's automobile industry. This study will fill the literature gap by comparing the costs and benefits of the most protected industry i.e the automobile industry.

2.2 Overview of the Automobile Sector of Pakistan

The automobile industry in Pakistan consists of firms or businesses involved in the production and assembling of passenger cars, light commercial vehicles, Heavy Commercial vehicles (trucks, buses), tractors, two-wheelers & three-wheelers. It is one of the major sub-sectors of large-scale manufacturing (adds 7% to LSM) and currently contributes 2.8% to total GDP and pays 30 billion rupees as taxes and duties (Board of Investment, n.d). After the petroleum industry, the auto industry is Pakistan's second-largest indirect taxpayer. The history of this sector in Pakistan started with the establishment of General Motors and Sales Company in 1949, which introduced the first-ever vehicle assembled in Pakistan named Bedford Truck. With time many other firms entered this sector and the industry started growing. In the 1970s this sector along with many other sectors was nationalized following the government's nationalization policy. During the 1990s government adopted a privatization policy that liberalized the automotive sector along with other major industries. Currently, the automobile sector of Pakistan is dominated by three Japanese firms namely Honda, Toyota, and Suzuki that have formed joint ventures in Pakistan named Honda Atlas Cars Ltd, Indus Motors Company Ltd, and Pak-Suzuki Motor Company Ltd respectively. These three companies have ruled the industry for nearly 30 years in an oligopolistic environment due to highly protective government policies (high output taxes and low input duties, high capital cost of Rs.10bn with a payback period of 5-10 years). In addition to these three JVs, the industry also contains Hino-Pak Motors, National Motors, and Gandara Nissan Diesel which manufacture trucks and busses while Al-Ghazi and Millat Tractors manufacture tractors. Atlas Honda, United Autos, Road Prince, Suzuki Motorways, Pakistan Motorcycles, and Yamaha are the manufacturers of two-wheelers and three-wheelers. Because of the tax incentives granted by the ADP 2016-2021, Pakistan's stagnating automobile sector experienced a significant shift in 2020, with five new companies (Changan – Master Motors, Hyundai – Nishat, MG – JW Automobiles, Proton – Al-Haj, Regal Motors – DFSK & Prince) entering the market.

Due to the low level of localization the financial performance of this sector has been always vulnerable to exchange rate risk. Most complex parts like engines and gearboxes are imported from Thailand and Japan, devaluation of our currency against them causes a large increase in the production costs of local manufacturers and assemblers. The forthcoming "Auto Industry Development and Export Policy, 2021-2026" is on its way to curing the existing disorders in the auto industry with its focus on Internal Combustion Engine Vehicles (ICEV) and aims for a slow transition to Hybrid Electric Vehicles (HEV) in the very long run. Furthermore, this policy aims to improve the export potential of the automotive sector (Tabish, 2021).

Table 2.1 Key Statistics of the Automobile Sector of Pakistan

Indicator	Value
Contribution to GDP	2.8%
Contribution to tax revenue	30 billion rupees
Spare parts Units	2,283
Assemblers	83
FDI	US$ 49.2 million
Manufacturers	2,200
Tier 1 producers	450
Tier 2 producers	452
Replacement market suppliers	1,325

Source: (Choangalia & Tabish, 2020)

2.2.1 Market share

The domestic automobile industry is mostly based on joint ventures by several international OEMs. In the heavy commercial vehicles (HCV) segment, Japanese companies fully dominate by acquiring 100 percent of the market share. In the production of busses, Hino-Pak Motors Ltd has the highest share of 47% followed by Master Motors Corporation Ltd with 29% share and Ghandhara Industries Ltd with 24% share. While in the production of trucks Ghandhara leads the market with a 48% share followed by Hino-Pak with 31% and Master Motors with 21% (Choangalia & Tabish, 2019). The Japanese firm also leads in the passenger cars and motorcycle market by holding about 90% of the total market share. Suzuki has a 29% market share in

passenger car production, followed by Toyota with 26% and Honda with 25%. In the production of motorcycles, Atlas Honda has the largest share of 52% followed by United Autos with 10.7% market share and Road prince with 6%. Whereas, a US-based firm named Massey Ferguson and an Italian company named Fiat dominate the tractor market (Qadir, 2016).

2.2.2 Trends in the Automotive Sector

Over the decades, the automobile industry of Pakistan has shown average performance in terms of growth, quality, productivity, and technology characterized by the low quality of output which does not meet international standards, low input materials, outdated technology, and insufficient training.

This industry had the best performance in the 1970s and 2000s, growing at a rate of 40% per year between 2001 and 2002 due to increased domestic demand. Production of passenger cars increased from 33,419 units produced in 1995-96 to 165,965 units produced during 2005-2006, showing a growth rate of 430% only in 10 years. During the same period motorcycles production also increased by 380% with the production of 520,124 units in 2005-2006 as compared to 106,797 units produced in 1995-96. Heavy commercial vehicle production also followed the same trend by showing a growth rate of 51% by trucks with the production of 4,518 units in 2005-2006 against 2,994 units in1995-96 and 74% by busses (Qadir, 2016).

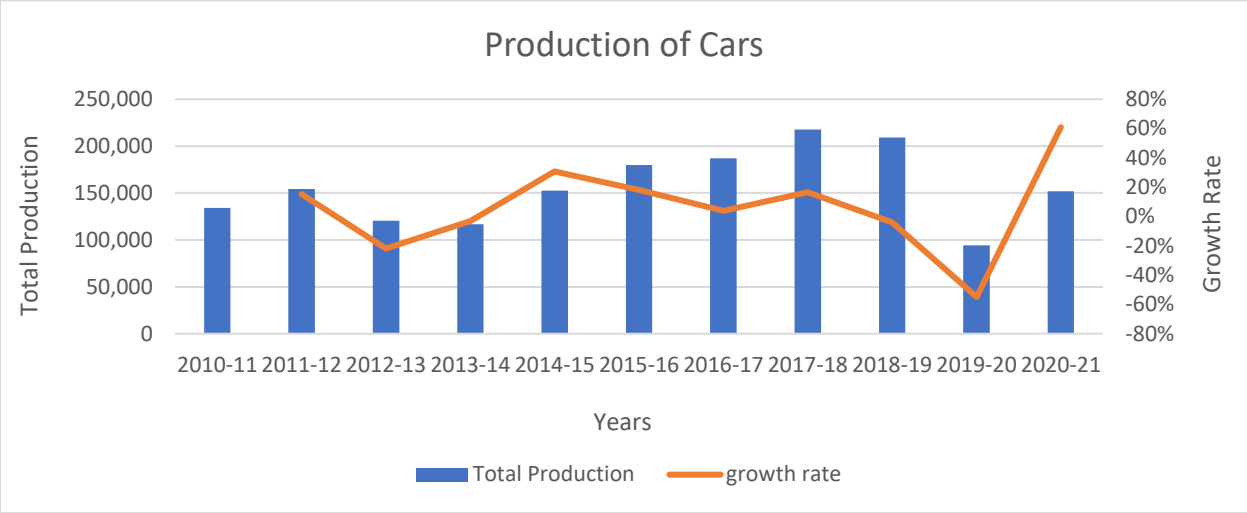
From the year 2013 to 2017, the overall auto sector showed a compound growth rate of 10% with the production of 277,537 units in the fiscal year 2017 against 189,628 units produced in FY13 dominated by car production (67%) followed by tractors (19%) Light commercial vehicles (10%) and heavy commercial vehicles (3.2%). The industry grew by 54.5 percent in agricultural tractors, 100 percent in jeeps, 36.1 percent in trucks, 4.49 percent in buses, 19.8 percent in motorbikes and three-wheelers, and 3.8 percent in passenger cars in 2017 (Punjab Board of Investment and Trade, 2018). The data for the last 6 years from FY13 to F19, shows that domestic car sales grew at a Cumulative Average Growth Rate (CAGR) of approximately and sales of local assemblers of busses and trucks have shown a CAGR of 10% and 17% respectively (Choangalia & Tabish, 2019). During FY21 despite abnormal economic conditions created due to COVID-19, the automobile sector of Pakistan showed positive growth. The production and sales of passenger cars increased by 36.4% (120,855 units) and 48.5% (126,679 units) respectively while light commercial

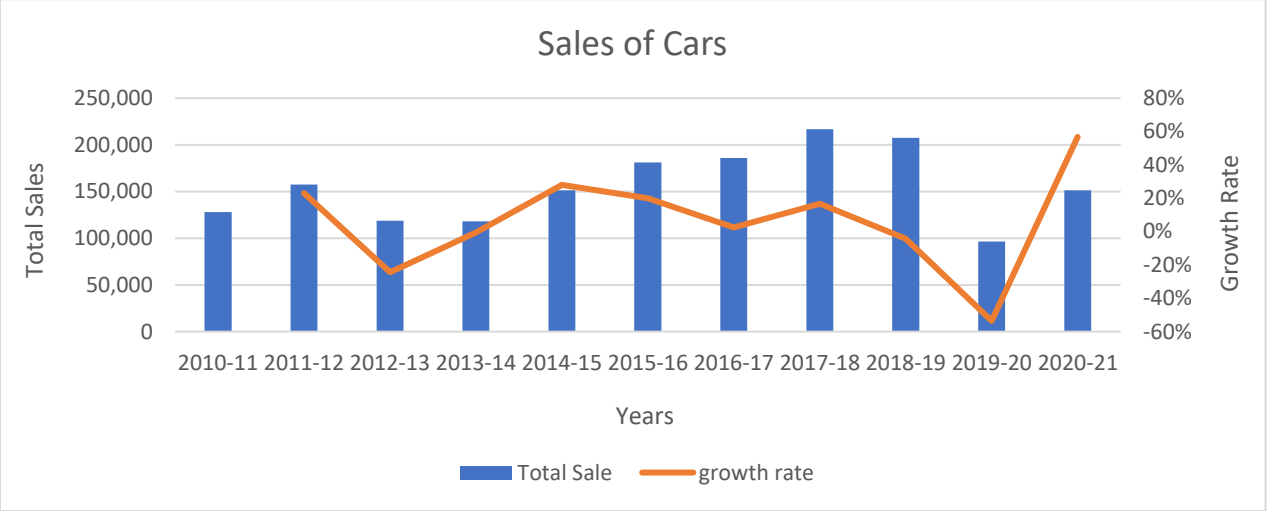
vehicles showed a 45.9% increase in production and 57.5% increase in sales and heavy commercial vehicles showed a 2.8% increase in production and 7.4% in sales. In the HCVs segment, busses production improved by 4.3 percent (482 units produced) whereas trucks' production increased by 2.6 percent (2,802 units produced). Farm tractor production and their sales increased by 65.2 percent and 62.2 percent, correspondingly. The two-wheeler and three-wheeler sectors increased by 33.5% (production) and 34.0% (sales). The overall growth rate achieved during July-March FY21 was 23.4% (Finance Division Government of Pakistan, 2021).

As compared to the growth rate of other manufacturing sectors of the economy, although this sector has outpaced other sectors in terms of overall production in recent years, localization of parts, consumer satisfaction, safety standards, and environmental compliance have all fallen short of expectations.

The percentage change in the production and sales of cars, trucks, busses, two-wheelers & three-wheelers, jeeps, vans & LCVs for the last ten years (2010-2020) is shown in the following figures.

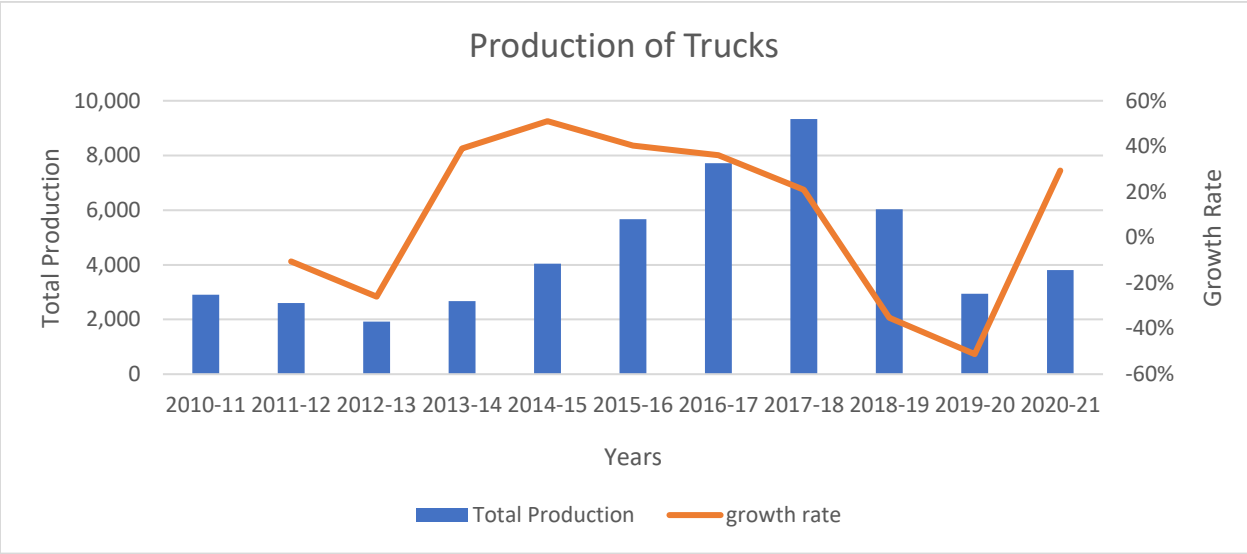
Figure 2.1 Production and Sales of Cars from 2010-2020

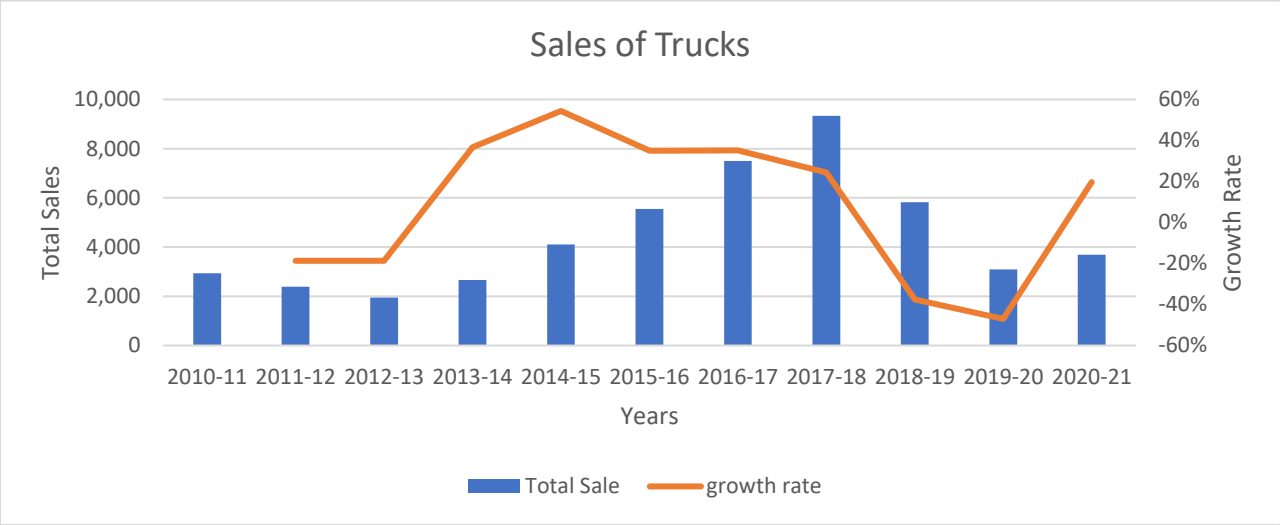




Source: authors calculation using data from (PAMA, 2021)

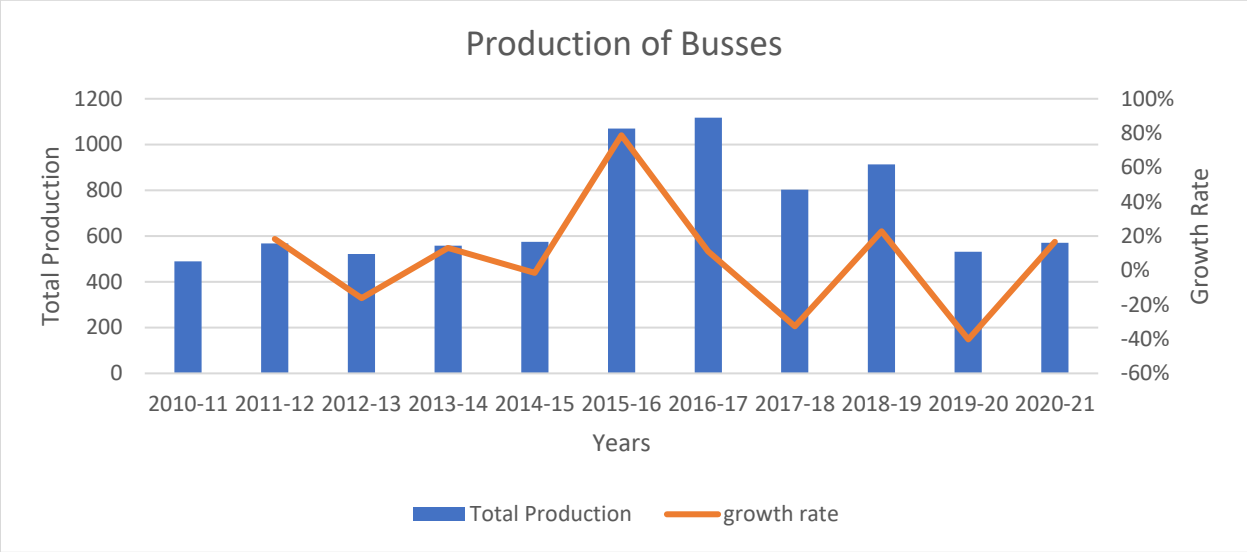
Figure 2.2 Production and Sales of Trucks from 2010-2020

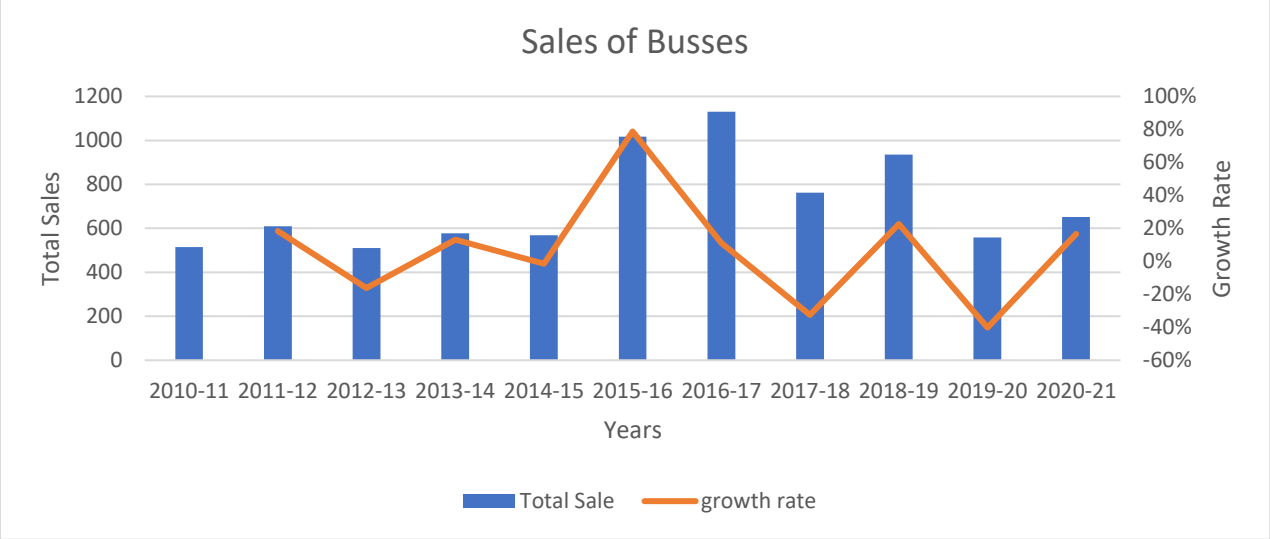




Source: authors calculation using data from (PAMA, 2021)

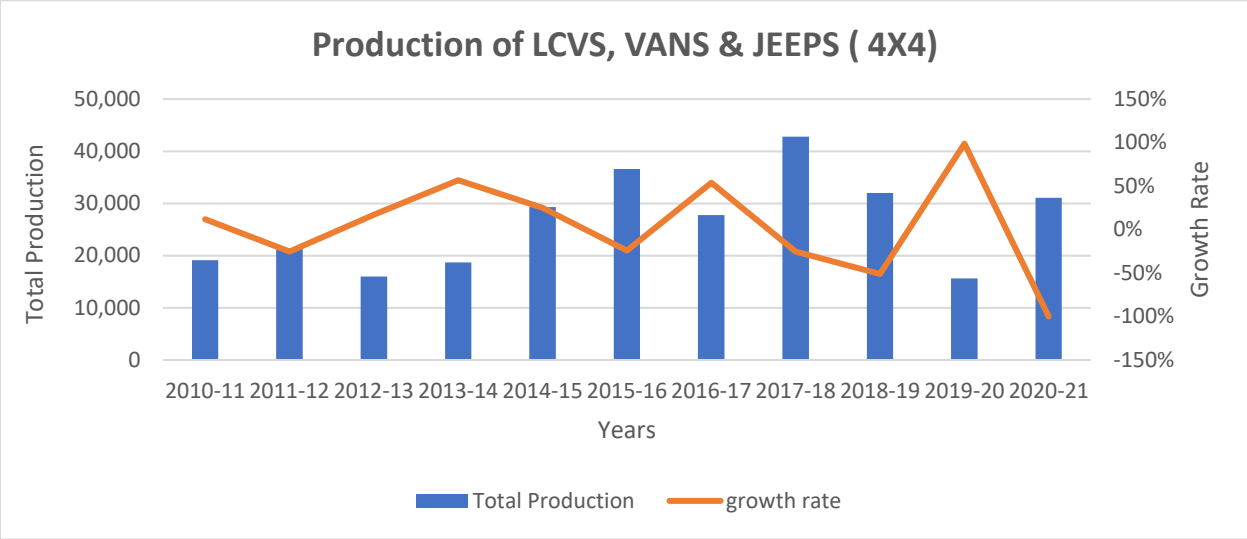
Figure 2.3 Production and Sales of Busses from 2010-2020

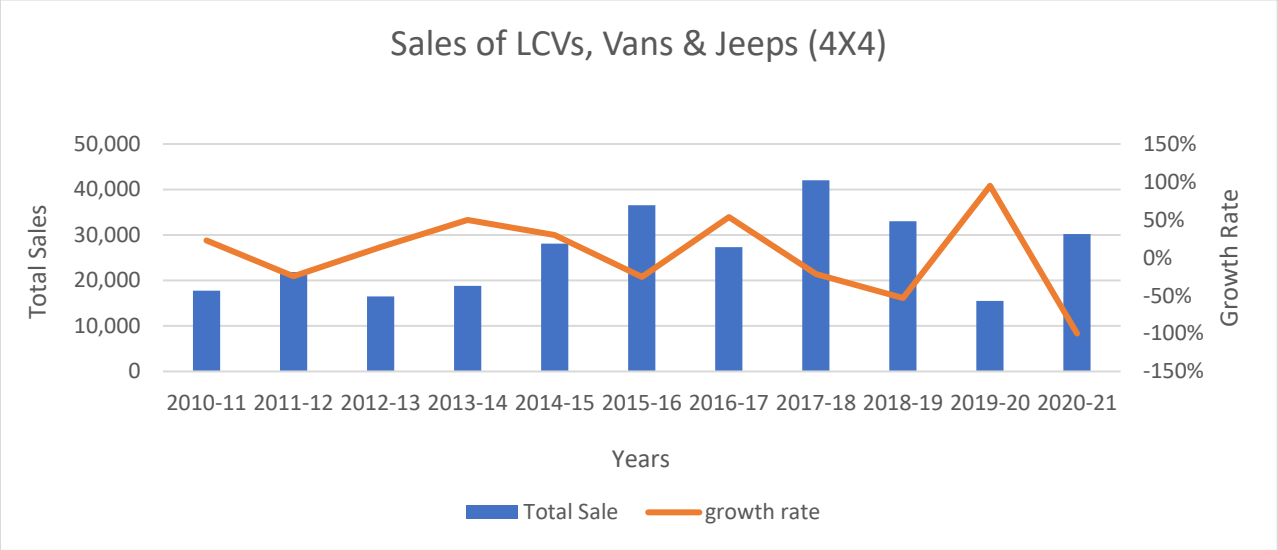




Source: authors calculation using data from (PAMA, 2021)

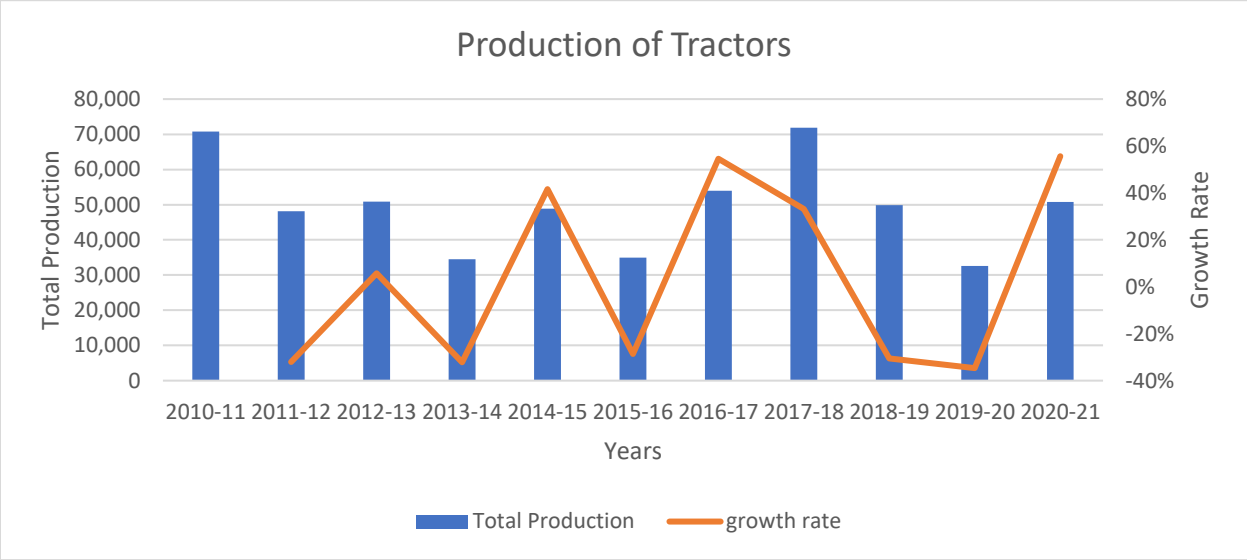
Figure 2.4 Production and Sales of LCVs. Vans, and Jeeps from 2010-2020

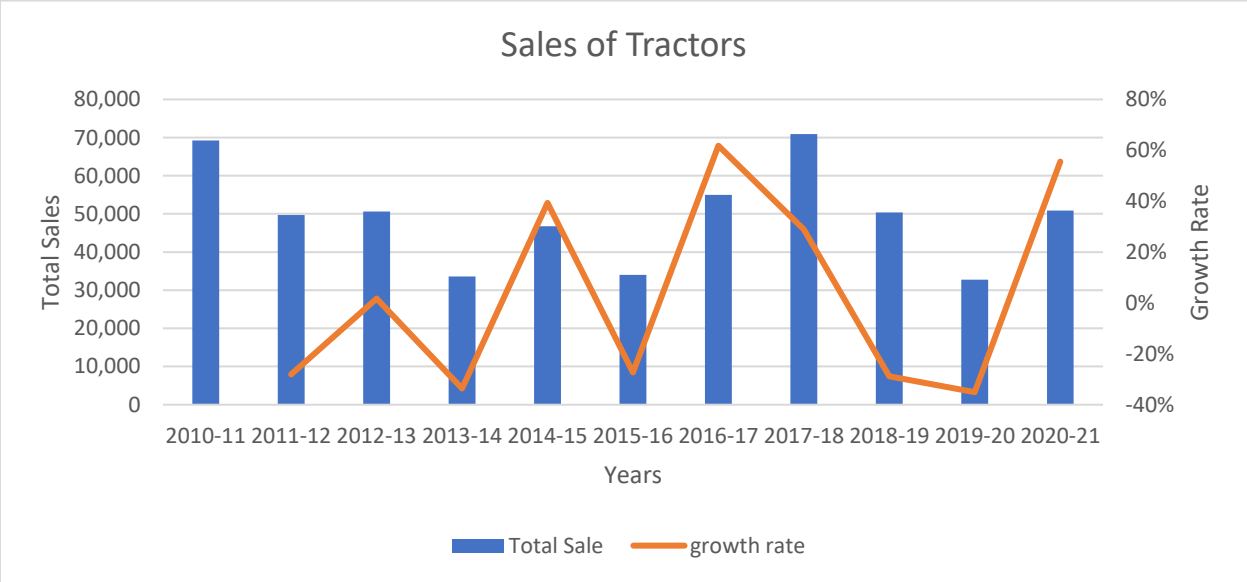




Source: authors calculation using data from (PAMA, 2021)

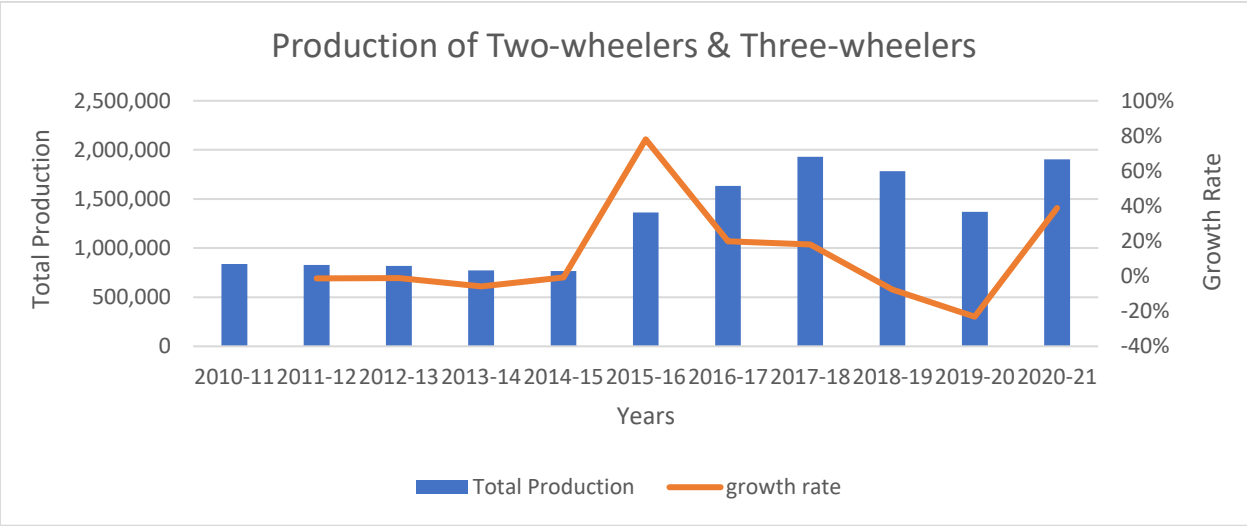
Figure 2.5 Production and Sale of Tractors from 2010-2020

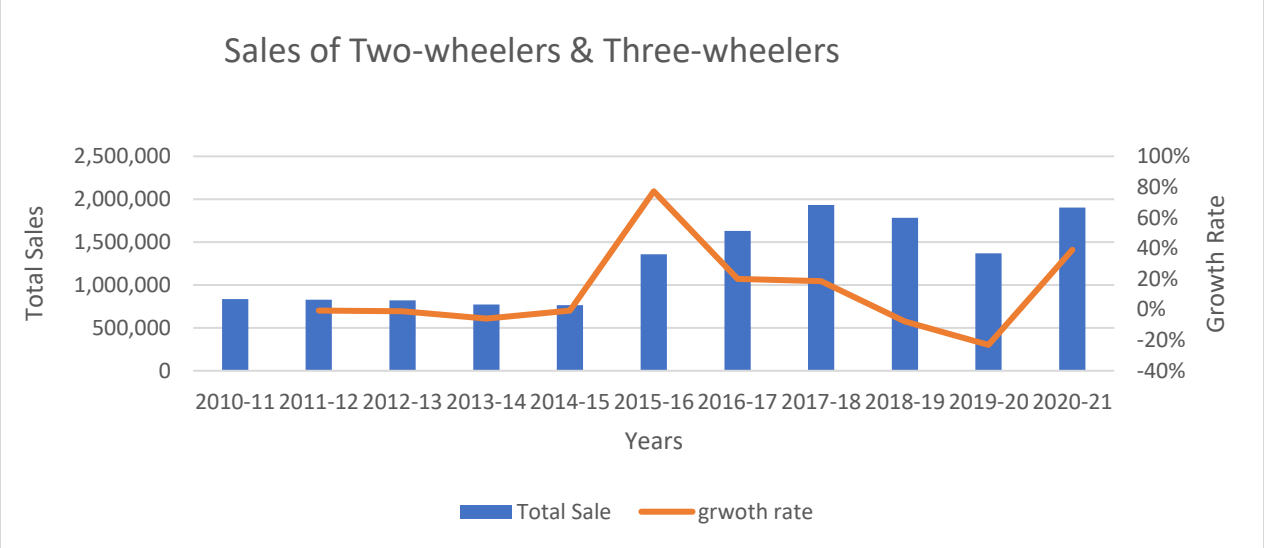




Source: authors calculation using data from (PAMA, 2021)

Figure 2.6 Production and Sales of two-wheelers and three-wheelers from 2010-2020





Source: authors calculation using data from (PAMA, 2021)

2.2.3 The Export performance of the Automotive Sector

Presently, the contribution of the Pakistani automotive sector to the world market is very small. It has been exporting only 2-4 percent of the total produced units of cars, busses, trucks, and two-wheelers for the last many years. For FY20, the value of export stood at $16 million only. Pakistan first entered the global export market by exporting vehicles (Land Rover Defenders) assembled by M/s Sigma Motors, to Sri Lanka. From 1997 to 1998 Nepal imported 12 Suzuki vehicles from Pakistan worth 2.888 million rupees and additional 93 units of pickups were exported to Bangladesh and Nepal in 1999. Indus Motors, the producer of the Toyota Corolla, has exported 2-4 units to Sri Lanka, Bangladesh, and Nepal on a trial basis in the last two to three years but has not been able to break into these markets since it is not economically viable. Similarly, the global export share of the auto parts industry is also very low. Only a minor share of domestically produced parts and components are exported to the world market. In 2016, Pakistan exported worth $175 million in auto parts where Indian exports stood at $10.8 billion during the same year (Ravi Magazine, 2017). Because of the excess capacity installed with demand less than the supply, Pakistan's automobile sector has a great potential for exports but due to high production costs, poor quality output, lack of appropriate export policies, and non-accessibility of good quality products in competitive market prices, the industry has not been able to show impressive growth and development.

In the following tables, the comparison of exports and imports for the last two years shows that our exports are negligible as compared to our imports.

Table2.2: Export Performance of the Auto Sector over the Last Two Years (Million USD)

PCT Chapter	Items	Exports (2019-2020)	Exports (2020-2021)	percentage Change
87	Vehicles Other Than Railway, Rolling Stock	45.00	72.87	61.93%
88	Aircraft, Spacecraft & Parts Thereof	2.25	0.61	-72.91%
89	Ship, Boats & Floating Structures	0.08	0.09	5.67%

Source: (Engineering Development Board, 2021)

Table 2.3: Imports performance of the Auto Sector over the Last Two Years (Million USD)

PCT Chapter	Items	Imports (2019-2020)	Imports (2020-2021)	percentage Change
87	Vehicles Other Than Railway, Rolling Stock	1,185.80	2,323.79	95.97%
88	Aircraft, Spacecraft & Parts Thereof	91.36	25.20	-72.41%
89	Ship, Boats & Floating Structures	157.07	487.69	210.49%

Source: (Engineering Development Board, 2021)

Table 2.4: Product-wise Exports of the Auto Sector over the last three years

	Pakistan's exports to the world Unit: 1000 USD		
Products	**2018**	**2019**	**2020**
Tractors	12,093	16,488	26,741
Prime-movers/Semi Trailers	2,542	10,268	7,243
Busses	119	232	66
Motor cars	607	1,195	351
Commercial vehicles	605	3,462	1,278
Motorcycles	90605	950	1,621
Special Purpose Vehicles	2,480	4,965	1,649
Bicycles	90	16	8
Automotive parts	18,589	17,229	14,555
Motorcycles & Bicycles Parts	487	478	373
Lead Acid Batteries & Parts	19,633	26,252	25,549
Rubber tires and tubes	133,833	16,926	19,291
total	**71,683**	**98,461**	**98,725**

source: (Engineering Development Board, 2021)

2.2.4 Motorcycle Industry of Pakistan

Pakistani motorcycle /two-wheeler industry started flourishing after 2004 with the entrance of new manufacturers supported by Chinese technology. Before 2004, there were only two dominant companies (Dawood Yamaha & Atlas Honda) and two other minor shareholders – Suzuki and Qingqi. Currently, the Pakistani motorcycle industry is the 5th largest market of two-wheelers in the Asia-Pacific. The market is dominated by Atlas Honda with 52.2% of sales followed by United Autos with sales up to 10.7% and Road Prince with 6.0%. Other famous companies are Suzuki Motorways, Pakistan Motorcycles, Yamaha, Superpower Motorcycles, Ravi Motorcycles, and Super Star. United Motorcycles offers one of the cheapest motorcycles in the segment of 70cc bikes, US70cc latest model is selling for as low as USD 270 only. The Pakistani motorcycle industry is among the fastest-growing in the world. In 2015 this sector achieved a ground-breaking record by producing 1 million units which further increased to 1.4 million sales in 2017 and 1.9 million sales in 2018 (McD Team, 2022). In 2019, 18,81,000 units of bikes were produced (Singh, 2021). During the period July to September 2020 motorcycle production and sales reached 8,05,408 units which is the highest ever quarterly output recorded in Pakistan (Ahmad, 2020). The Automotive Development Policy 2016-2021 became successful in achieving its objectives in the

two-wheeler segment. A higher level of localization has been achieved by two-wheeler manufacturers.

2.2.5 Auto Parts Industry

The auto component sector assists the automobile assemblers and the replacement market. The Pakistani auto parts manufacturing industry produces parts and components for cars, tractors, buses, two-wheelers, three-wheelers, and other markets. Major types of auto components like trim, body parts, and electric parts are manufactured locally while engine and suspension parts are imported (Bari et al., 2016). Auto component producers serve as vendors and suppliers to local Original Equipment Manufacturers (OEMs), offering a variety of automobile components for use in vehicle assembly. The auto parts market in Pakistan is divided into two groups, one is the auto parts manufacturers whose primary customer is the OEMs that use these parts and components in the assembly of new cars. The second group supply repaired and original parts in the local markets and aftermarkets. The auto parts and component manufacturing units in Pakistan focus and specialize in the creation of single-unit parts while globally auto parts producers supply a variety of parts by joining various components. In the beginning, Pakistani auto parts producers entered the global market as tier 3 manufacturers[1] (supplying raw materials for auto parts) but with the increase in globalization and global demand, a small number of Pakistani companies were able to be tier 1 manufacturers with the ability to export.

During the period of nationalization in the 1970s, the auto parts industry was established in Pakistan with the initial production of gears, castings, and cylinder blocks. In the 1990s, privatization policy gave a boost to the auto parts and components manufacturing industry which was further strengthened by Product Specific Deletion Program (PSDP) in 1995. The purpose of PSDP was to protect and support the new auto parts manufacturers by defining clear rules for localization under which the automobile producers were required to use 70% of the local content. Due to the PSDP scheme, the domestic auto parts sector showed remarkable growth in terms of volume. However, in 2007, Tariff Based System (TBS) replaced PSDP which produced new hurdles for local auto component manufacturers in the form of foreign competitors, because TBS

[1] Tier 1 includes assembly manufacturers; Tier 2 consists of auto component manufacturers; Tier 3 includes molding & dying manufacturers

allowed imports of parts produced domestically subjective to high tariff rate while import of parts not produced locally was subjective to low tariff rates. TBS allowed auto manufacturers to expand their sourcing options by importing from other countries but with increased costs in the form of higher tariff rates.

At present, about 1,700 automotive parts manufacturers are operating in the Automotive Industry of Pakistan. The parts manufacturers are largely indigenous capital companies while the OEM assemblers are managed by Japanese companies. 200-240 companies supply parts for OEM production and a number of these are involved in the manufacturing of repair parts. Currently, the Pakistani auto parts industry exports only 4% of its total production, and its major export is to Asia and Europe. In recent years, technology in the auto parts sector has improved considerably contributing to a higher growth rate. Most notable technological innovations that occurred in this sector include industrial automation, CO2 and spot welding, pressure die casting, iron casting, and the use of a power hydraulic press (Board of Investment, n.d).

Pakistan is manufacturing nearly 90% of parts and components of tractors, two-wheelers, and three-wheelers, and 70 percent of parts for cars and heavy commercial vehicles locally for Original Equipment Manufacturers (OEMs), to supply in the export market and domestic market. Currently, the size of the automotive industry is Rs.370 billion which is worth 20 billion rupees is contributed by the local vendors who supply accessories and spare parts to different automobile segments (Firpo, 2019).

JICA (2011) surveyed automotive vendors to evaluate their level of production technology, quality, and safety standards. The study interviewed a sample of 140 automotive component manufacturer firms in the organized segment to examine the state of the industry. The survey results showed that the majority of the component manufacturers use simple and labor-intensive technology instead of capital-intensive technology. Technology was not being updated with the passage of time and many production units were using the outdated technology of the 1980s and most of the vendors were not exposed to modern production technology. Only a few firms were able to supply specialized capital-intensive and modern equipment to OEMs. The quality of steel plates produced in the country was of a substandard quality which caused an increase in imports of steel to meet local demand. Lack of information about potential markets and customers and

absence of marketing overseas were the main hurdles for export promotion of this sector according to the component manufacturers.

There are four main reasons why auto parts manufacturers and assemblers in Pakistan are not able to attain capacity production. First, it does not possess the required skills to adapt itself to the changes that are frequently occurring in the technical and technological, financial, and institutional arena. Second, frequently changing and inconsistent government policies discourage investment. Third, lack of competition and insignificant sales volume. Fourth, high rate of inflation. The industry can improve its performance if it is provided with technical support, finance for growth and diversification, and training for the production of new parts (Niazi & Bhatty, 2011)

Table 2.5 Automobile Parts and Components Manufactured in Pakistan

Engine Valves	Saddles
Gear Box	Silencers and Exhaust Pipes
Forged Machined Parts	Filters
Timing Gears / Transmission	Wheel Rims and Spokes
Hand Brakes	Molds (Steels)
Radiators Cop Assy	Heat Treated Steel Components
Gear Box Shafts	Pistons/ Cylinder Liners
Bottles / Tanks& Moldings	Forged Machined Parts
Rubber Parts	Hub and Fire wheels
Expansion Tanks	Axle, Brake Discs

Source: (Tauseef & Raza, 2020)

Trends in the Auto Part Sector:

In FY20 the approximate size of the auto parts and components industry was USD~2,920mln (PKR~460bln) while its imports were USD~263mln (PKR~42bln) with a 49% reduction due to the COVID-19 pandemic situation as compared to FY19. Pakistan imports parts and components (typically engine and suspension parts) mostly from Japan, Thailand China, and Indonesia. During FY19 imports from Thailand were 39% of total imports followed by Japan, China, and Indonesia with 19%, 18%, and 13% of the total share respectively. The global export share of the Pakistani auto industry is very low, only a minor percentage of domestically manufactured parts and

components are exported to the world market. In 2016 value of auto part exports was US$ 175m where Indian exports stood at US$ 10.8b. Its exports stood at USD~16mln (PKR~2,514mln) during FY20. In the following tables, a comparison of the exports and imports of auto parts shows that our exports are negligible compared to our imports.

Table 2.6 Exports of Auto Parts Industry for the last three fiscal years (2018-2020)

Destination	**FY18**		**FY19**		**FY20**	
Country	Amount US$1000	Percentage share	Amount US$ 1000	Percentage share	Amount US$ 1000	Percentage share
USA	2,795	17%	3,461	20%	3,698	23%
UK	3,057	18%	3,827	22%	3,031	19%
Italy	1,923	11%	1,772	10%	1,219	8%
Other	9,000	54%	8,166	47%	8038	50%
Total	16,774		17,226		15,986	

Source: (Tauseef & Raza, 2020)

Table 2.7 Imports of the Auto Part Industry for the last three fiscal years (2018-2020)

Destination	**FY18**		**FY19**		**FY20**	
Country	Amount US$1000	Percentage share	Amount US$ 1000	Percentage share	Amount US$ 1000	Percentage share
Thailand	204,189	34%	208,919	41%	91,043	35%
Japan	98,318	16%	82,027	16%	49,842	19%
China	90,656	15%	66,363	13%	47,334	18%
Indonesia	98,183	19%	74,766	15%	34,819	13%
Other	111,928	16%	81,575	16%	40,240	15%
Total	**603,275**		**513,649**		**263,278**	

Source: (Tauseef & Raza, 2020)

2.2.6 Trade Policies in the Automotive Sector

Government intentions for intervening in industry development are usually articulated in some policy forms such as industrial policy, trade policy, fiscal policy, etc. The automotive industry operates under the umbrella of many policies and regulations like the Industrial Policy, Trade Policy, Finance Acts (which adjust the tariff and fiscal system backed by the SROs), Customs General Orders, ISDP (Industry Specific Deletion Program), Auto Development Programs, Tariff Based Scheme (TBS), Yellow Cab Scheme, Product-Specific Deletion (PSDP), and the National Environmental Quality Standards.

This sector has always been given a high level of protection against the foreign competition through different policy measures like tariffs (indigenization programs) and non-tariff barriers. During the 1990s government introduced the Yellow Cab Scheme[2], this policy to some extent reduced protections provided to this sector but this gave a setback to local industry as it could not able to compete with the foreign competitors. The huge reduction in the production of domestic vehicles (from 65,000 to 45,000) forced the government to again adopt protectionist measures which resulted in the adoption of new policies that imposed a ban on the import of new cars and used cars older than three years and very high rate of customs duty were imposed on Completely Built-Up Units (CBU) and CKD (Completely Knocked Down Units) kits. High tariff barriers became effective against foreign competition and protected the local manufacturers to a greater degree but these tariff barriers had to be reduced from 2001 to 2005 due to WTO agreements. Another policy measure that adversely affected the auto sector was the drastic reduction in import duty on CBUs of higher CC cars in 1993. This posed a great threat to the Indus Motor Company which was at its initial stages during that time. Furthermore, in 1998 government took another threatening step toward the local auto industry by allowing the import of 678 luxury cars by reducing the import duty from 400% to 125% and imposing a 100% regulatory duty on luxury cars above 1800cc (Ravi Magazine, 2017). The introduction of ADP 2016-2021 enhanced opportunities for the local auto part producers to expand their market shares however the industry did not be able to gain profit from this policy measure mainly because of higher competition from imported auto parts and components. There are several reasons behind this poor performance of the auto

[2] under this scheme government allowed duty free import of cars of mass distribution as Taxis in the Pakistani market and forced the domestic assemblers to divert their production facilities to the production of taxis

sector – one, very high import duties on CBUs have highly protected this sector thus promoting fiscal opportunism or rent-seeking; second, government policies like deletion programs and non-tariff based protection limit the entry of new players thus promoting monopolies and creating uncompetitive economic environment (Asian Development Bank, 2008).

The performance of the auto industry has been seriously affected by the inconsistent policies of the government. During the last 60 years, policies related to the auto sector have been changed 36 times, these recurrent changes in policies have adversely affected manufacturers forecasting abilities and hence their output production and growth. The industry has been facing difficulties due to the unpredictable and varying policies formulated and implemented by the government of Pakistan since the time of the formation of this sector (Qadir, 2016). Nevertheless, despite fluctuating policy environment, this sector has been able to produce engineering capabilities all over its value chains, and employment opportunities and has also managed to participate in the global export market, especially in exports of motorcycles, auto parts, and tractors(Bari et al., 2016).

Indigenization programs:

In the 1990s, Pakistan used the Deletion/Indigenization Program to impose localization restrictions as a policy approach to strengthen the domestic sector. In 1988 many engineering products including vehicles were put under local content programs like PSDP and ISDP. The purpose of PSDP was to protect and support the new auto parts manufacturers by defining clear rules for localization under which the automobile producers were required to use 70% of the local content. While ISDP set targets for the industry to attain an indigenization level up to a certain time duration. These programs were initially formulated and managed by the Ministry of Industries and after 1995 by Engineering Development Board (EDB). The main objective of these programs was import substitution by supporting the local auto industry to reach the level of indigenization in the production of vehicles as set by the government and to attract foreign direct investment. Firms that participated in these programs were provided concessions and exemptions on import duties by incorporating them in various SROs. Local content included in-house production of input material and components, and the purchase of materials from other domestic manufacturers to help grow the domestic component and sub-component manufacturers. In the automotive sector of Pakistan, these local content policies did well in attracting investment from some multinational automobile

companies. Currently, the three main multinational automobile manufacturers in Pakistan effectively monopolize their specialized market segments: Suzuki has the largest market share in the low-priced small car segment, Honda is the market leader in the medium-size segment and Toyota leads in the larger size, higher price segment. The below tables show the level of indigenization achieved during different periods.

Table 2.8 Indigenization level achieved in 1995

Vehicles	Indigenization level	Vehicles	Indigenization level
Suzuki Mehran 800cc	58%	KIA Ceres	26%
Suzuki Khyber 1000cc	44%	Honda Motorcycles	70%
Suzuki Margalla 1300cc	35%	Suzuki Motorcycles	65%
Suzuki Pick Up 800cc	52%	Yamaha Motorcycles	70%
Suzuki Potohar 1000cc	35%	Honda Civic	28%
Suzuki Van 800cc	47%	Tractor Messey Ferguson	84%
Toyota Corolla	28%	Tractor Fiat	84%

Borrowed from: (Aqil, Qadeer, Ahmed, & Qureshi, 2014)

Table 2.9: Level of Indigenization achieved in 2005

Category	Indigenization Level
Passenger cars	Up to 72%
LCVs	Up to 52%
Busses	Up to 52%
Tractors	Up to 85%
Trucks	Up to 52%
Motorcycles	Up to 89%

Borrowed from: (Aqil et al., 2014)

Table 2.10 Indigenization level achieved till 2020

Category	Indigenization level
Passenger cars and LCVs	50% - 60%
Motorcycles	~90%
Busses and Truck	~30%
Tractors	~85%

Source: (Tauseef & Raza, 2020)

These degrees of localization have been reached through decades of investment in the local parts vendor network (through knowledge transfer, joint ventures with foreign component vendors, training, and direct investment) as well as in-house part manufacturing. The above-mentioned tables show that the indigenization level for motorcycles and tractors is much higher than for passenger cars and LCVs, buses, and trucks. In the production of motorcycles and tractors, 96% of domestically produced parts and components are used whereas in the car segment level of localization varies with the type of OEM (Tauseef & Raza, 2020)

Tariff Based Systems (TBS):

The Deletion Program was replaced by a new policy called Tariff Based Systems (TBS) on 1st July 2006 when Pakistan joined the World Trade Organization (WTO). Under TBS local component suppliers were protected through tariffs. TBS introduced three new SROS - SRO 655(I)2006, SRO656(I)2006, and SRO 693(I)2006. These SROs increased protection for vendors and Original Equipment Manufacturers (OEMs) by reducing the customs duty rate on raw materials, components, and sub-components. For example: in SRO 655(I)2006, rate of CD on raw materials is 0%, on sub-components 5%, on components 10% and on sub-assemblers 15%. Under TBS, Only those assemblers were allowed to Import units in CKD condition who had required assembly facilities and who were registered with the sales tax department. Imports of localized CKD forms were subjected to a high rate of import duty, whereas parts that had not yet been indigenized were allowed to be imported at the MFN rate of customs duty.

Auto Industry Development Program (AIDP) 2007:

AIDP was a five-year program for the auto industry announced in 2007 to achieve the production of 500,000 vehicles by 2012. It was founded as a result of the government's reforms in industrial policies, which were driven by its WTO membership. This policy also supported and incentivized new players by providing tariff concessions on the import of completely knocked-down kits without using any domestically produced component. While the Auto Industry Development Program achieved many of its objectives, sustainable development of the sector fell below expectations, especially in the context of attracting foreign investment and offering consumers the opportunity to choose from a broader range of vehicles promising quality and safety while complying with the same time with environmental standards (Qadir, 2016).

Table 2.11 *AIDP Targets Vs Actual Production: (1000 units)*

	2006-2007	2007-2008	2008-2009	2009-2010	2010-2011	2011-2012
Production target	200	250	310	380	440	560
Actual production	203	194	112	143	254	179
Shortfall/excess	3	56	198	237	286	381

Borrowed from: (Qadir, 2016)

Automotive Development Policy (ADP) 2016-2021

In 2015, the Automotive Development Policy 2016-21 was introduced. ADP 2016-2021 outlines objectives for the country's automotive industry to permit bigger volumes, attract investment, assure increased competitiveness, and provide higher quality in response to increasing prospects inside the country and the region. The policy's other goal is to strike a balance between industrial growth and tariffs to secure long-term viability for all stakeholders while prioritizing consumer welfare. ADP aimed to produce more than 350,000 cars by 2021 and lowered the entry barriers for new investment. the import duty on localized parts was lowered as an overall policy of tariff reduction to improve indigenous competitiveness, induce efficiency, encourage technology up-gradation and enable the auto parts manufacturing industry to become globally competitive. Previously, localized auto components were a part of SRO 693(I/2006) and were subject to higher import duty vis-à-vis localized parts. Furthermore, the import duty rates on CBUs (only for 1800 cc and below) have been rationalized for vehicles as higher duty rates make imported vehicles overly expensive and this pricing trend also drives up the prices of locally produced vehicles. It facilitates new players or competitors to build their manufacturing and assembling units through the provision of duty-free imports of plant and machinery to compete effectively with the prevailing three auto assemblers (Honda, Suzuki, and Toyota), functioning since 1990.

Main Features of ADP 2016-2021:

Particular	Greenfield Investment	Brownfield Investment
Description	Setting up of new and independent automotive manufacturing and assembling plant for the production of vehicles of a make not already being assembled or manufactured in Pakistan	Restoration of a prevailing assembling or manufacturing unit that is not operational or closed before 01-06-2013 & the make-in has not been in production in the country since the date.
Plant/manufacturing unit	A Time Duty-free import of plants & machinery for manufacturing/assembling	
Test Models	Import 100 vehicles of the same kind in CBU form at 50% of the prevailing duty for pilot testing after launching the project.	
Customs Duty	25% on localized parts (45% for current players) & 10% on non-localized parts (30% for current players)	25% on localized parts (45% for current players) & 10% on non-localized parts (30% for current players)
Incentive Provided	5 years of cars and LCVs	3 years for cars and LCVs
Trucks, Busses, and Prime Movers	Import of all parts at current custom duty applicable to non-localized parts for the production of trucks, prime movers, and buses for 3 years.	
Motorcycles	Prevailing policies as approved by the GOP	

Source: (Engineering Development Board (EDB), 2016)

As a result of this policy, more than 12 automakers announced a collaboration with different companies in Pakistan, under the Greenfield as well as Brownfield investment categories. However, only five new companies (Changan, Hyundai, MG, Proton, and Regal Motors) were able to materialize whereas most of the investments were either completely pulled off or put on hold due to various reasons including the country's volatile economic conditions, depreciating currency value, and continuous shift in government policies related to imposing taxes & duties (Ansari, 2020). Among the existing players (Suzuki, Honda, Toyota) Toyota was the only one who brought out a new car in 2020, i.e. the Toyota Yaris.

Changan – Master Motors:

Changan entered Pakistan this year with the assistance of Master Motors, a well-known bus and truck manufacturer and member of the Master Group of Industries. They launched the only sedan in the form of the new Changan Alsvin; which comes with a choice of inline 4-cylinder engines and a 5-speed dual-clutch automatic gearbox. Changan is one of China's big four state-owned automakers, and they've had a lot of success in their nation.

Hyundai – Nishat:

One of the world's largest automobile manufacturers brought their Tucson crossover to Pakistan this year with a 2.0 liter naturally aspirated 4-cylinder engine. Tucson looks very similar to the 2019 entrant, the KIA Sportage, and is also its major rival. this is Hyundai's second venture into the Pakistani market. Their previous entry was with the Dewan Farooque Group in the mid-2000s. However, low sales volumes and a global recession prompted an early exit.

MG – JW Automobiles:

Another entrant in the growing crossover market for 2020 is the MG HS which comes with a 1.5 liter turbocharged inline 4-cylinder engine. Morris Garages began as a British automobile manufacturer known for its racing heritage and sports vehicles. The business was a subsidiary of the MG Rover group, which went bankrupt in 2005. It was taken over by SAIC, a Fortune 500 company and another one of China's Big 4, and production in China began in 2007.

Proton – Al-Haj:

Proton is partly owned by Greely and partly owned by DRB HICOM. This Malaysian manufacturer is testing the Pakistani market with its crossover, the Proton X70. It also comes with a 1.5-liter turbocharged 4-cylinder engine with a 7-speed dual-clutch crossover. The Al Haj group, an emerging conglomerate with interests in Oil & Gas, Fuel Procurement, Heavy Mining, and Textile, is Proton's local partner in this venture. They also assemble FAW big commercial trucks on a local level.

Regal Motors – DFSK & Prince:

Regal Motors in cooperation with DFSK launched Prince Pearl, an 800 cc 3-cylinder compact car for the budget-minded consumer. Their most recent model, though, is the Glory 580 Pro, a midsize SUV. This 7-seater is a more luxurious version of the 580, which debuted last year and is similarly powered by a 1.5-liter turbocharged 4-cylinder engine.

Analysis of ADP 2016-2021:

To summarise, the ADP 2016-2021 has only produced partial outcomes. When the policy was launched, it was predicted that cars Volkswagen, Fiat, Renault, Nissan, Hyundai, Kia, JAC, Changan, Zotye, and Chery will compete against the existing Japanese competitors in Pakistan during the next five years. Despite all the incentives, no newcomer has yet to produce a single product that can compete with any of the existing options. When it came to the advantages of ADP-2016, it made the locally produced products look a little better than they did a few years before. Due to competition, Pak Suzuki had to discontinue the MK-II Cultus after 17 years and introduced the new Celerio in 2017. After 30 years, Mehran was replaced by an 8th generation Alto. Toyota has started to include immobilizers and airbags in all of its locally built vehicles and has recently launched the new Yaris sedan. When seen in a larger context, however, these advantages are of little or no value because the market is still dominated by 3 players, and most of the products offered by these companies are still (in terms of price) beyond the reach of many, obsolete and globally retired products continue to be assembled here, and most importantly none of the entrants pose any threat to the established players. The ADP-2016 was unable to give benefits to automobile consumers in this country at large (Ansari, 2020).

2.2.7 Effective Protection Rates:

EPRs are used to measure the degree or level of protection provided to any industry, firm, or sector. The main purpose of the SROs system is to provide additional protection (effective protection) to the local manufacturers by reducing their cost of production through exemptions and concessions on imported inputs to achieve import substitution and export promotion. Since concessions provided in SROs range from zero to 100 percent for different industries, firms, and products as a result, EPRs vary widely across different industries, firms, and products. One main reason for large variations EPRs is the lobbying power of both the producers and consumers. Pakistan's automobile sector has long benefited from high levels of protection. The below table shows the ERP enjoyed by the auto industry in 1997.

Table 2. 12: Effective Protection Rate to Automobile Industry (1997)

Vehicle Type	IMPORT CKD/RM	TARIFF CBU %	TARIFF CKD/RM	EPRs %
1500 CC	70%	150%	32%	425%
800 CC	40%	110%	32%	162%
TRACTOR	20%	35%	32%	36%
Vendors using S-form	30%	45%	20%	56%
Without S-form	30%	45%	65%	36%
Without S-form & competing against smuggled items	30%	20%	65%	1%

Borrowed from: (Aqil et al., 2014)

The main objective to provide high EPR was to support the local manufacturers and assemblers to increase the usage of local contents (indigenization) but despite achieving the main objective the local manufacturers became profit-oriented and uncompetitive. Aqil et al. (2014) show how EPRs have been misused by these auto manufacturing companies resulting in creating monopolies, and offering low standard and higher price vehicles for consumers. Pak Suzuki Motor Company retained Rs.148.716 million profit in 2002 as compared to Rs.52.97 million in 2001.

Effective protection rates were estimated by Pursell et al. (2011) for vendors and assemblers of automobiles and the overall production of cars by considering it as a single combined process including activities of the assemblers, vendors, and in-house part manufacturers. Effective protection rates (EPRS) were calculated using different assumptions about input-output ratios and considered parameters. Based on the input-output ratios the study considered a 50% tariff for CBUs of engine capacity below 800cc, 50% tariff for localized parts, 32.5% tariff rates on non-localized parts, and 5 % tariff on imported raw materials by vendor firms. Results based on the considered tariff structure showed vendors of auto parts manufacturers, and assemblers enjoy 95% and 120% EPR respectively. As a single integrated unit, the automotive manufacturing process has a 104% EPR (from inputs to final production of a vehicle).

Advantages and disadvantages of protectionism

Protecting local industry from foreign competition provides jobs to thousands of people, is helpful in export promotion and import substitution, and in the form of import duties and taxes, it is a major source of government revenue. On the other hand, Higher import duties on CBUs and a ban on the import of used cars have suffered the consumers (higher prices and fewer choices) and has welfare losses to the people of our country. Secondly, protecting local industries has created a monopoly for the local producers with little or no innovation and technological change. Another negative aspect of protection is revenue lost due to the ban on the import of used cars and due to the higher reductions in import duties on CKD.

2.2.8 Present Structure of Import Tariffs (CDs) for the Automotive Sector of Pakistan

- Excessively high CDs on the import of CBUs leading to an import ban. Presently, different tariff rates are depending on the type of engine cylinder capacity.
- High tariff rates on components, sub-components, and spare parts that are locally manufactured. Lower tariffs on kits of non-localized parts.
- Low tariffs (between 0-10 percent) on components and raw materials used as inputs by registered domestic auto parts manufacturers.
- Ban on the imports of used cars (except imports under the gift scheme and imports by Pakistani citizens returning from abroad)

Table 2. 13: Tariff rates for cars, LCVs, and SUVs (Auto Parts)

Products	2018-2019	2019-2020	2020-2021
Raw materials	1%	1%	1%
components	10%	10%	10%
Sub components	10%	10%	10%
Sub assembly	20%	20%	20%
CKD (localized)	45%	45%	45%
CKD (non-localized)	30%	30%	30%

Source:(EDB, 2021)

Table 2. 14: Tariff Structure for Busses and HCVS

Products	2018-2019	2019-2020	2020-2021
Raw materials	1%	1%	1%
components	1%	1%	1%
Sub components	1%	1%	1%
Sub assembly	1%	1%	1%
CKD (localized)	35%	35%	35%
CKD (non-localized)	5%	5%	5%

Source: (EDB, 2021)

Table 2. 15: Tariff Structure for Agriculture Tractors

Products	2018-2019	2019-2020	2020-2021
Raw materials	1%	1%	1%
components	1%	1%	1%
Sub-components	1%	1%	1%
Sub-assembly	1%	1%	1%
CKD (localized)	35%	35%	35%
CKD (non-localized)	1%	1%	1%

Source: (EDB, 2021)

Table 2. 16: Tariff Structure for Motorcycle, Cargo Loaders, and Three Wheelers

Products	2018-2019	2019-2020	2020-2021
Raw materials	1%	1%	1%
components	10%	10%	10%
Sub components	10%	10%	10%
Sub assembly	20%	20%	20%
CKD (localized)	45%	45%	45%
CKD (non-localized)	15%	15%	15%

Source: (EDB, 2021)

2.3 Summary

To sum up, despite the various policy measures (discussed above) taken by the government to promote the local automobile industry, it was not able to achieve the objectives of protectionism and the policies have mostly remained ineffective in the promotion of this sector. Its contribution to GDP is low and it remained less competitive and highly dependent on imports in the form of CKDs. Notwithstanding the benefits provided through SROs, Except for motorcycle production, the overall performance of the vehicle industry has fallen short of its real potential. With very few exceptions, vehicle manufacturers use obsolete technology, continue to rely on fuel-inefficient technologies, and provide fewer features than identical cars in the worldwide market. The technologies employed in the small car sector are outdated and have been phased out in the global market. Due to delayed deliveries by the OEMs there always exists a gap between demand and supply. There is no single company in Pakistan for the manufacturing of important functional auto parts like engines and transmissions. Domestic consumers are also being deprived of the best available technologies and basic safety considerations like airbags, ABS, etc. In terms of performance, three players dominate the passenger automobile category in Pakistan, with shortcomings such as a lack of safety and reliability features, surplus unutilized production capacity, and a lack of competition. Pakistani passenger car prices are much higher than in other nations due to high levels of protection and little local competition. In India, a consumer under a 7 lakh budget can choose from 29 available options and in china, there are more than 55 for a buyer to choose from. In this price range, the only option available in Pakistan is the Suzuki Mehran. vehicles Pakistan's present automotive policy is exceedingly complex and distortive when viewed as a whole. It favors insiders by ensuring high profits for foreign-owned assemblers and provides only limited employment, little technology transfer, and high final pricing for Pakistani consumers (Secretariat, 2015). If we compare the equipment and safety with the same cars offered in other markets worldwide, Pakistan's local cars are far behind. Pakistani consumers pay much higher prices for obsolete cars compared to neighboring countries

Some examples:

1. Suzuki Mehran, the cheapest locally assembled car in Pakistan is a 2nd generation Suzuki Alto of the 1980s. The base VX model comes without airbags or anything that a basic 21st-

century car offers globally yet it cost more than 7 lakh rupees. It was globally discontinued in 1988 whereas Pakistan introduced it in 1989 and stopped its production in 2019.

2. Suzuki Swift was launched globally in 2004 and phased out by 2010 while Pakistan launched it in 2010. It cost more than PKR 20 lakh in Pakistan whereas in India it costs PKR 10 lakh.
3. 5th generation Honda City became obsolete in the world by 2013 when Pakistan first time launched.
4. Honda City's 6th generation was introduced in 2014 elsewhere and was replaced by the 7th generation City in November 2019. Whereas Pakistan introduced the 6th generation City in 2021 which comes with airbags for the first time. Honda City 5th generation's price in Pakistan is above PKR 14 lakh while Honda city 6th generation (far better than our 6th Gen) in India PKR13 lakh.
5. The Pakistani variants lack important features like airbags, CVT transmission, rear parking, one-touch sunroof, steering switches, etc. than identical cars in the worldwide market. For example; A comparison of Indian Honda City (VX) with Pakistani Honda City (1.5 Aspire) shows that the Indian version has airbags, CVT transmission, rear parking sensor, one-touch sunroof, and steering switches that Pakistani City does not have.
6. The 1.8 liter Corolla Altis base model in India starts from PKR 2.1 million while in Pakistani its price is approximately the same but, the same Altis in India is equipped with driver and passenger airbags, immobilizers compared to Pakistani Altis which offer one airbag only and no immobilizers.
7. There are still plenty of vehicles on sale in Pakistan which come without airbags like Suzuki Bolan, Suzuki Ravi, United Baro, Suzuki Alto, and Suzuki VXR to name a few.

CHAPTER 3

DATA AND METHODOLOGY

This study is analytical and uses secondary data for the calculations of the costs and benefits of SROs. Data is collected from World Integrated Tarde Solution (WITS), Federal Board of Revenue (FBR), International Trade Center (ITC), and OECD.

To measure the cost of SROs and associated benefits, the study considered all the concessionary Customs Duty SROs related to the automobile industry of Pakistan issued by the Federal Board of Revenue (FBR) during the last ten years (2010-2020). A total of 20 concessionary custom duty SROs were issued during the period under study and among these 20 SROs, only 8 provide tariff concessions and exemptions,[3] while in the remaining 12 SROs the effective tariff and tax rates have been increased by the imposition of Regulatory duties (RDs) and Additional Custom Duties (ADs). Since the objective is to calculate the costs of SROs so only those eight SROs are selected for further calculations which provide concessions and exemptions (see table 3.2), among these 8 concessionary SROs, SRO 499(I)2013 and SRO 567(I)2014) were not considered because of their minor impact on the overall tax expenditures.

There are several costs and benefits associated with SROs; potential costs include distortions in the competitive economic environment, disruption of the level playing field, tax expenditures, rent-seeking, and complexity in the tax regime, while benefits include revenue generation, employment generation, and support, and promotion of domestic industries. This study estimated the costs of SROs as tax expenditure and benefits as social welfare. For calculations, SRO-wise data on imports, exports, and MFN tariff rates have been obtained from WITS at HS-6 digits and the reduced CDs rates are taken from their respective SROs. Average MFN values for the years 2019 and 2020 were missing in the data from WITS, they were manually calculated from FBR yearly published customs tariff data books for 2019 and 2020. As the HS coding system for Pakistan is based on HS 8-digits while the data obtained from WITS is based on HS-6 digits, the data obtained

[3] Concessions and exemptions have been provided to different categories like raw material, assemblies, components, sub-components.

from WITS are the average values. Due to this reason, our calculations for tax expenditures may be a little bit over/underestimated from actual tax expenditure. After collecting the data, calculations for tax expenditures were performed.

3.1 Measuring Tax Expenditure

Amhed and Ather (2014) calculated tax expenditures using the revenue forgone method, which calculates tax expenditures as the amount of tax that would have been collected if no concessions had been granted. While Pasha and Pasha (2015) estimated tax expenditures as "the revenue losses due to concessions and exemptions in the tax code." This study calculated tax expenditure as the gap between potential tax revenue, which does not contain tax concessions and exemption, and the realized tax revenue with these concessions.

$$Tax\ expenditures\ =\ Potential\ tax\ collection\ -\ Actual\ tax\ collection$$

Where potential tax collection, is the amount of tax collected under MFN or normal duty rates, and actual tax collection is the amount of tax collected under the effective CD rate given in the SROs.

$$potential\ tax\ revenue\ =import\ value\ *\ MFN\ rate$$

$$actual\ tax\ revenue\ collected\ =\ import\ value\ *\ SRO\ tariff\ rate$$

The difference between the tax revenue calculated at the normal or MFN tariff rate and the tax revenue collected at the SRO tariff rate is taken as a tax expenditure.

3.2 Measuring social welfare

For the estimation of benefits accrued due to the provision of these SROs, the study performed a simulation exercise to measure the impact of an SRO on the consumer surplus, producer surplus, and tax revenue. The aggregation of consumer surplus and producer surplus gives the net social welfare impact of an SRO.

3.2.1 Simulations based on the partial equilibrium model

To perform simulations, we used the SMART (Simulation and Modeling Assistant for Research and Training). SMART is a market access simulation package included in the World Integrated Trade Solutions (WITS). It is a partial equilibrium modeling tool. The term "partial equilibrium" refers to an analysis that only evaluates the impacts of specific policy action in the market(s) that are directly affected, rather than the economic interactions between the many markets in a given economy. There are two main advantages of the partial equilibrium approach to market access analysis. First, it requires minimum data, and second, it allows analysis at a disaggregated/detailed level thus avoiding aggregation bias. The package uses structurally estimated parameters in a partial equilibrium framework to work out the impact of various tariff reduction scenarios. On the supply side, export prices are exogenously given, and price-taking behavior is assumed which implies infinite export supply elasticity. On the demand side, consumer behavior is modeled using the Armington assumption which specifies that imports sourced from different countries are imperfect substitutes.

SMART examines the effects of a tariff adjustment scenario on one importing market and its exporting counterparts by generating new values for a set of variables. It calculates the impact of trade policy (tariff reductions) on tariff revenue, consumer surplus, and producer surplus. Tariff revenue change on a given import flow is calculated as the final ad valorem tariff multiplied by the final import tariff (SRO tariff rate) less the initial ad-valorem tariff (MFN rate) times the initial import value. Welfare changes are what the economy as whole gains by reducing tariffs (the reduction in deadweight loss). The gain consists of the aggregation of consumer surplus (accrued due to the increase in imports) and producer surplus.

Table 3.1: List of SROs issued during 2010-2020

S.NO.	SRO.NO	Title of the SRO	Issue Date
1	SRO (I)2010	Amendments in S.R.O 577(I)/2005	15th February 2010
2	S.R.O 479(I)2011	Amendments in S.R.O.482(I)/2009	3rd June 2011.
3	SRO 1402(I)2012	Amendment in SRO 656(I)2006	30th November 2012
4	SRO 1404(I)2012	exemption of CD on import of CBU motorcycles and components	30th November 2012
5	SRO 607(I)2012	Exemption of customs duty, sales tax, and withholding tax	2nd June 2012
6	SRO 586(I)2012	Free Trade Agreement with Sri Lanka	1st June 2012
7	SRO 499(I)2013	Exemption of customs duty, sales tax, and withholding tax	12th June 2013
8	SRO 742(I)2013	Amendments in S.R.O. 482(I)/2009	28th August 2013
9	SRO 567(I)2014	Amendments in S.R.O. 499(I)/2013,	26th June 2014
10	SRO 280(I)2014	Free Trade Agreement with Sri Lanka	8th April 2014
11	SRO 607(I)2015	Amendment in SRO 656(I)2006	30th June 2015
12	SRO 1190(I)2015	Amendments in S.R.O 482(I)2009	1st December 2015
13	SRO 1189(I)2015	Amendments in S.R.O 693(I)2006	1st December 2015
14	SRO 484(I)2016	Amendments in S.R.O 693(I)/2006	29th June 2016
15	SRO 482(I)2016	Amendment in SRO 655(I)2006	29th June 2016
16	SRO 575(I)2017	Free Trade Agreement with Sri Lanka	1st July 2017
17	SRO 1035(I)2017	Imposition of regulatory duties (RDs)	16th October 2017
18	SRO 644(I)2018	Exemptions of CD on CBU of electric vehicles	24th May 2018
19	SRO 640(2018)	Imposition of regulatory duties (RDs)	24th May 2018
20	SRO 680(I)2019	Imposition of regulatory duties (RDs)	28th June 2019

Table 3.2: List of SROs considered in the study

S.NO.	SRO.NO	Title of the SRO	Issue date
1	SRO 1402(I)2012	Amendment in SRO 656(I)2006	30th November 2012
2	SRO 1404(I)2012	exemption of CD on import of CBU motorcycles and components	30th November 2012
3	SRO 586(I)2012	Free Trade Agreement with Sri Lanka	1st June 2012
4	SRO 280(I)2014	Free Trade Agreement with Sri Lanka	8th April 2014
5	SRO 607(I)2015	Amendment in SRO 656(I)2006	30th June 2015
6	SRO 482(I)2016	Amendment in SRO 655(I)2006	29th June 2016
7	SRO 575(I)2017	Free Trade Agreement with Sri Lanka	1st July 2017
8	SRO 644(I)2018	Exemptions of CD on CBU of electric vehicles	24th May 2018

CHAPTER 4

RESULTS AND FINDINGS

4.1 Results

Table 4.1: Year Wise Tax Expenditure Estimates for Customs (USD)

Years	Tax expenditures
2013	$ 53.08 million
2016	$1.48 billion
2017	$2.054 billion
2018	$1.969 billion
2019	$ 1.118 billion
Total	$8.420608 billion

Table 4.2: Tariff Revenue and Net Welfare Effects of SRO-based Tariff Reductions (USD)

SRO	Consumer Surplus	Producer Surplus	Tax revenue	Net Welfare Effect
SRO 1402(I)2012	53,251.99769	0.942652511	-44338.54346	53252.94
SRO 1404(I)2012	6,926.0371	0.942653	-4817.384	6926.98
SRO 607(I)2015	2834837.443	4.607800524	-2200023.655	2834842.051
SRO 482(I)2016	5518286.74	23.62246789	-4597023.57	5518310.362
SRO 644(I)2018	7275.837446	0.016949255	-5849.180158	7275.854396

Table 4.3: SRO-wise tax expenditures estimates for customs duty (in USD)

S.NO.	SRO	Description	Issue Date	Tax Expenditures
1	SRO1402(I)2012	Amendment in SRO 656(I)2006. i.e. Exemption of CD on components imported in any kit form for assembly or manufacture of vehicles falling under Chapter 87	30th November 2012	$46.718 million
2	SRO1404(I)2012	exemption of CD on import of CBU motorcycles and components, as are more than 57.5%, for one year.	30th November 2012	$6.370 million
3	SRO 586(I)2012	Free Trade Agreement with Sri Lanka	1st June 2012	0
4	SRO 280(I)2014	Free Trade Agreement with Sri Lanka	8th April 2014	0
5	SRO 607(I)2015	Amendment in SRO 656(I)2006. i.e. Exemption of CD on components imported in any kit form for assembly or manufacture of vehicles falling under Chapter 87	30th June 2015	$2.663 billion
6	SRO 482(I)2016	Amendment in SRO 655(I)2006. i.e. exemption of CD on raw materials, sub-components & sub-assemblies	29th June 2016	$5 billion
7	SRO 575(I)2017	Free Trade Agreement with Sri Lanka	1st July 2017	0
8	SRO 644(I)2018	Exemptions of CD on CBU of electric vehicles	24th May 2018	$6.802 million

4.2 Findings

Estimates of tax expenditures reveal that, compared to 2013, tax expenditures have increased during the period of analysis, reaching a peak in 2017 with a value of $2.054 billion compared to $ 53.08 million in 2013. During 2016, 2018 and 2019 total tax expenditures were $1.48 billion, $1.969 billion, and $ 1.118 billion respectively. While there are no tax expenditures for the years 2010, 2011, 2012, 2015, and 2020 because no concessionary SROs issued during these years. The overall tax expenditures under these SROs for the time under review (2010-2020) have been estimated to be $ 6.683 billion. SRO-wise tax expenditures show that SRO 482(I)2016 has caused the highest tax expenditure of $5 billion. SRO1402(I)2012, SRO1404(I)2012, SRO 607(I)2015, and SRO 644(I)2018 caused $46.718 million, $6.370 million, $2.663 billion, , and $6.802 million in tax expenditures respectively. Tax expenditures under SRO 586(I)2012, SRO 280(I)2014, and SRO 575(I)2017 are zero because no concessions were given to the automobile sector under these SROs.

SMART returns results as Consumer surplus (CS), producer surplus (PS), tariff revenue, and net welfare effect. Table 4.2 provides results of five SRO-based tariff reduction scenarios on tariff revenue, consumer surplus, producer surplus, and net welfare effect. Under SRO 1402(I)2012 Pakistan gained $53,252.00 as consumer surplus, and $0.94 as producer surplus resulting in a net welfare gain (CS+PS) of $53,252.94, and lost potential customs revenue worth -$44,338.54. The reduction of tariffs under SRO 1404(I)2012 resulted in CS and PS amounting to $6,926.04 and $0.94 respectively with a net welfare gain of $6,926.98 and tariff revenue loss of -$4,817.38. SRO 607(I)2015, resulted in a net welfare gain of $2,834,842.05 with the creation of $2,834,837.44 in consumer surplus and $4.61 in producer surplus while reduced tariff revenue by -$2,200,023.66. Under SRO 482(I)2016, Pakistan lost potential customs revenue to the tune of -$4,597,023.57, however it gained CS worth $5,518,286.74 and PS worth $23.62 resulting in a total welfare gain of the amount of $5,518,310.36. The government lost Tariff revenue worth -$5,849.18 as a result of tariff concessions given under SRO 644(I)2018 and entailed a net welfare gain of $7,275.85 with CS of the amount of $7,275.84 and PS of the amount of $0.02. Negative values of tariff revenue imply that revenue gain from increased imports is not enough to dominate revenue loss due to tariff decrease.

The reduction of tariffs under SRO 1402(I)2012, SRO 1404(I)2012, SRO 607(I)2015, SRO 482(I)2016, and SRO 644(I)2018 resulted in a net welfare gain (CS+PS) of $53,252.94, $6,926.98, $2,834,842.05, $5,518,310.36, and of $7,275.85 respectively. The aggregation of welfare generation by all the considered SROs is $8.420 million.

Empirical results show that the considered SROs created 6.683 billion dollars in tax expenditures while their benefits to the society are worth 8.42 million dollars which is 0.12 percent of the total costs. Thus it is concluded that the costs of SROs highly outweigh their benefits. Due to the provision of these SROs, a small group gains benefit at the expense of the whole society. The $6.6 billion tax revenue forgone accrued to a specific industry while their costs are borne by all the taxpayers in the form of poor quality vehicles at higher prices. The rationale behind the provision of SROs is to increase social welfare but the empirical results show that welfare generation by these SROs is less than one percent of their total costs.

In addition to monetary costs, SROs have discouraged innovation and promoted monopolies in the automobile sector. The main objective for protecting the local auto manufacturers through the SRO regime was to encourage localization and import substitution but the objective has not been fully achieved until now as the manufacturers are still dependent on imported CKDs and the level of localization for passenger cars is only 50 to 60 percent as of the year 2020. According to the latest data by the Pakistan Bureau of Statistics Pakistan imported CKD kits worth $168 million in march 2022, which is the highest ever month-wise. The passenger cars' prices are much higher compared to other countries and lack basic safety features (airbags) and use outdated technology. In Pakistan, there is no single producer for the production of important auto parts like engines and transmission systems. The automobile assemblers were given significant protection but the localization program was not properly implemented by the assemblers, and the government did not hold them accountable for not following the program. Some sectors may require strategic protection, but such protection should be limited in time and have a definite end date. Protected sectors should have a strong accountability system in place because protection generates rents, which, if not collected by the government, exacerbate economic and societal imbalances.

To sum up, protection provided to the automobile sector of Pakistan through different policies like indigenization programs, ban on the import of used cars, and very high import duties on CBUs

have made the industry uncompetitive and dominated by three companies with little technological advancement, low localization, poor quality output, higher prices, and sluggish exports. With only three major players in the business, there are limited options for the buyers. Vehicles are placed in such a way that they do not directly rival each other thus safeguarding each other interests. like, Suzuki has a monopoly in the low-price small car segment, Honda monopolizes the medium size car segment while Toyota is the market leader in the large size high price car segment. Competition drives performance and encourages the adoption of innovation as businesses grow and new ideas flourish in the market. The fair and open competition also means lower prices and greater choices for consumers and ensures the progress of the industry which is absent in the automobile industry of Pakistan.

CHAPTER 5

CONCLUSION AND RECOMMENDATIONS

5.1 Conclusion

Pakistan's taxation system offers disproportional treatment to different sectors. Some industries benefit from greater protection than others, and some industries are heavily taxed in comparison to others. Pakistan's trade strategy is formulated in such a way that annual budgets offer the broad direction of the policy. However, if the government wants to adjust the effective tariffs throughout the fiscal year, it uses SROs to do so. Pakistan's tariff system has been complicated by the use of SRO culture. The practice of issuing SROs dates back to 1988 when the indigenization program was launched. The program attempted to boost the percentage of local content in manufacturing, particularly in the car and engineering items. Firms that took part in the scheme were given SROs that permitted them to import particular inputs at reduced tariffs. However, rather than individual units, the recent practice of issuing SROs has centered on industries. Pakistan's automobile sector has always been protected against foreign and local competition through a variety of legislative measures implemented by the government throughout time. However, efforts aimed at promoting this industry have largely been ineffective. Protection of the industry through various restrictions and barriers in the form of different policies like indigenization policies have made the industry uncompetitive. The production system and technology face many weaknesses due to the lack of competition in the industry caused by localization requirements. Foreign investment also remained low in parts of the industry. Trade liberalization has not been supported by the automotive industry of Pakistan, which has led to consumers facing higher prices, low-quality standards, and inadequacy of competition in this sector. Consumer welfare is completely absent from the overall tariff plan, even though the sector receives a lot of protection. Local manufacturing is weak, and exports are sluggish, despite heavy protection and several export promotion programs. In Pakistan, the SRO regime has always protected the existing players thus leading to a lack of competition and quality of output. Due to protectionist regulations, automakers artificially inflated automobile prices and sacrificed quality and safety equipment such as dual airbags and side-impact bars, among other things. Local industry protection should be time-limited, with a defined sunset date

and accountability for rent-seeking. exemptions and concessions in import tariffs should be supplied through tariff codes rather than SROs and difficult-to-use export-oriented systems (Nasir, 2020).

The proposed study aimed to consider the concessions and exemptions provided through SROs and performed a cost-benefit analysis of these SROs with a special focus on the automobile industry of Pakistan. This study considered concessionary customs duty SROs provided to the automobile sector of Pakistan during the period 2010 to 2020. The costs of these SROs have been calculated as tax expenditures and benefits have been measured in terms of the net welfare effect (consumer surplus + producer surplus). The overall tax expenditures under these SROs for the period under review (2010-2020) have been estimated to be around $ 6.68 billion, while the net welfare is around $ 8.42 million. The estimates show that the costs of SROs are larger as compared to their benefits. The study concluded that concessions and exemptions extended to the automobile sector of Pakistan under various SROs considered in this study outweigh the benefits.

5.2 Recommendations

The SRO system has always protected established players, resulting in a lack of competition and poor output quality. The tariff policy must strike a balance between industry requirements and consumer welfare, protection and competition, import and domestic production, and must give a clear incentive for new investments in the auto sector to foster healthy competition between existing and new participants. The deletion scheme was not entirely implemented, and 60 percent of these vehicles' parts are still imported. Thus, it is suggested that market expansion would be achieved by lowering entry thresholds creating an investment conducive environment for local and foreign firms to enter the market and compete with the existing automobile manufacturers.

It is recommended that firstly concessions in the form of SROs should be granted based on three criteria: First and foremost, concessions should concentrate on new industries and activities. Second, to discourage rent-seeking, those concessions should include a built-in sunset provision. Third, a mechanism for benchmarking success should be introduced and implemented. Secondly, If the system could be changed into an industrial policy/strategy with greater innovation, transparency, and efficient use of fiscal resources, the complications produced by these SROs may be mitigated. Thirdly, Exemptions and concessions received by different products in multiple

SROs must be thoroughly investigated, and tariffs on individual products should be the same for all importers i.e. either SRO-based concessions and exemptions should also be provided to the commercial importers or they should be merged into the normal tariff structure.

5.3 Limitations of the Study

The findings of the current study provide an insight into the research topic. However, two major limitations were faced during the study; one, data collection, and second, time and resource constraints. As the HS coding system for Pakistan is based on HS-8 digits while the data obtained from WITS is based on HS-6 digits, thus the data obtained from WITS are the average values. Second, due to time and resource constraints, the study could not be able to throw light on other aspects of SROs like rent-seeking, employment generation, and productivity of concerned industries/firms.

5.4 Future Research

Future research can focus on other aspects of SROs like rent-seeking, productivity, and employment generation with the help of primary data to critically explore and analyze different aspects (positive and negative) of SROs.

CHAPTER 6

QUALITATIVE PART

This chapter presents the analysis and findings of the data obtained from the interviews conducted with the respondents as part of the qualitative study. To find the impacts of SROs on the economy of Pakistan and their potential costs and benefits. The qualitative method used in this study is non-standardized interviews (face to face and telephonic) and discussions with the experts from National Tariff Commission, World Bank, and World Trade Organization. The interviews are recorded, transcribed, and analyzed with their consent and keeping ethical concerns in front. One interview was conducted face to face while the other two were through ZOOM meetings as chosen by respondents. The average duration of an interview was almost 25 minutes. The objectives of the interview and the scope of this study were explained to each respondent before starting the interview. The respondents respond to all questions, the responses to the questions were recorded and then transcribed manually. All the interviews were recorded through a smartphone recorder with the prior permission of the respondents and then transcribed for the themes extraction process.

The below table shows the profiles of the respondents including interviewee name, associated organization, Designation, and mode of interview.

Table 8.1: Respondents' profile

S.No.	*Name*	*Designation*	*Interview Mode*
1	Dr. Robina Ather	Chairperson NTC	Zoom meeting
2	Dr. Manzoor Ahmad	(Ex-Ambassador, WTO)	Face to face
3	Gonzalo J. Varela	Senior Economist, World Bank	Zoom meeting

6.1 Qualitative Findings

Based on the interviews and discussions with the knowledgeable people, the findings of the qualitative study are as follow:

Q1. What are the major objectives of SROs:

The respondent explained that SROs are provided to reduce the cost of production by making raw material and input goods cheaper to enhance total factor productivity, output growth, import substitution, and export promotion.

Q2. What are the potential costs and benefits (Positive and negative impacts) of SROs?

While discussing the costs and benefits of SROs respondents shared that tax concessions are provided either through SROs or/and different schedules attached to the law. SROs, especially trade-related SROs erode competitiveness and promote monopoly if provided for a long time. Furthermore, one of the respondents believed that due to these SROs the concentration on the value –chain is absent in our country. The world is moving towards a value chain and we are still stuck with the schemes like indigenization of parts and local content requirements. He gave the example of the Indian economy that how after trade liberalization, the Indian auto sector started growing by getting rid of its license-based import scheme which was the same as the current SROs scheme in Pakistan, and became self-sufficient with quality output and also started exporting its automobiles in the world market while at the same Pakistani products cannot meet international standards. one major reason for the poor performance of the auto sector in Pakistan is the local content requirement because the local products are of poor quality and are not acceptable in the world market and in this way SROs have restricted the entry of foreign investor in the automobile sector of the country. The respondent took the example of Mercedes Benz which wanted to enter the Pakistani auto market for manufacturing and export purposes but due to the conditionality of local content requirements, they were not able to enter because local inputs do not meet their standards. He further added that Localization of all the automobile parts is neither possible nor efficient because by doing so we cannot achieve economies of scale. So Pakistan should focus on value-chains to modernize and become competitive globally. One of the respondents argued that SROs are bad for long-term development for three reasons; one, SRos are drafted in a way that

prevents innovation because in general, the concessions come with specific conditions, and the conditions are imposed to preserve the status quo. For example, a textile producer gets raw materials at a lower import duty but is restricted to use them in the proportions as determined in the SROs (input-output tables). This condition limits innovation because the manufacturers may introduce new ways to achieve a more efficient output which they cannot do under this restriction. Second, SROs create large fiscal costs due to which the collection of tax revenue by FBR is less than its potential while the benefits of these concessions go to specific groups at the expense of others. Third, the whole system of SROs is a system that enables institutions to hold the process of policymaking and they are highly likely to be affected by an elite capture.

Regarding the benefits of SROs, the respondents mentioned that SROs are beneficial in a way that: since the tariff rates in Pakistan are very high so the manufacturers need input concessions to compete in the domestic and global market. One of the respondents stated that the highly fluctuating exchange rate increases the cost of production of manufacturers, and the provision of SROs has to some extent minimized the impact of the highly fluctuating exchange rate, if these concessions were not been given then the fluctuating exchange rate coupled with higher import duties would have highly increased the cost of production for manufacturers.

Q3. How can we calculate the costs and benefits of SROs?

The answer to this question was provided by One of the respondents that; the calculation of tax expenditures would provide the costs associated with the SROs while the benefits of SROs can be seen in terms of welfare generation and by estimating growth, productivity, and exports (in case of export-oriented industries) of those industries or firms which have been given SRO-based tax concessions and by

Q4. Do SROs promote Rent-seeking?

One of the respondents explained that; historically, most of the SROs were provided during 2004 and 2005 when tariff rates were escalated, different industries like the automobile industry, pharmaceutical industry, textile industry, etc. approached FBR for tariff concessions and hence those who approached FBR were provided with tax concessions in form of SROs. At that time this might have caused rent-seeking but at present, SROs are generalized, there is no such SRO that

has been provided to individual units/firms rather concessions in SROs cover the entire industries/sectors so there is a little probability of rent-seeking. However, the other respondents believed that even at present these SROs are for the elite class and benefit large businesses at the expense of SMEs. Currently, there are some SROs that allow duty-free import of machinery for some specific sectors like textile and not for other major revenue contributing sectors. Which shows the hidden motives of big players in the economy.

Q5: How SROs have impacted the level playing field in the economy?

The respondents shared that SROs hurt the level playing field because they are provided to some sectors while others cannot get benefit from them. Most of the SROs are provided to manufacturers and are not provided to other commercial importers. SMEs cannot avail the concessions provided in these SROs because of the conditions attached to these SROs which these SMEs cannot fulfill (excess paperwork, licenses, etc) so they buy inputs and raw materials at higher costs from commercial importers which buy those at MFN rates. Hence, SROs only benefit large manufacturers.

It is concluded from the point of view of the experts that there are several costs and benefits associated with SROs. SROs restrict innovation, promote rent-seeking, erodes competitiveness, promote monopolies, decrease tax revenue, and kill the level playing field in the economy. SROs are designed in such a way that they impede innovation since, in most cases, concessions come with certain conditions, which are imposed to protect the status quo. SROs promote rent-seeking because they only benefit large businesses while SMEs cannot avail themselves. Trade-related SROs erode competitiveness and promote monopoly if provided for a long time. SRO is a system that enables institutions to hold the process of policymaking and they are highly likely to be affected by an elite capture. Furthermore, due to these SROs which necessitate localization of auto parts, the concentration on the value –chain, and economies of scale is absent in our country. One major reason for the poor performance of the auto sector in Pakistan is the local content requirement because the local products are of poor quality and are not acceptable in the world market and in this way, SROs have restricted the entry of foreign investors into the automobile sector of the country. While at the same time SROs are beneficial for substitution of imports, promotion of exports, and minimizing the impact of highly fluctuating exchange rate. Since the

tariff rates in Pakistan are very high so the manufacturers need input concessions to compete in the domestic and global markets. If concessions were not given, then the fluctuating exchange rate coupled with higher import duties would have highly increased the cost of production for manufacturers.

The respondents suggested four ways to confront the problems associated with SROs. First, instead of giving SRO-based concessions, the general tariff rates should be reduced so that every sector either small or large would get benefits from tariff concessions and there will be a level playing field. Second, concessions should concentrate on new economic activities and sectors. Third, to discourage rent-seeking, those concessions should include a built-in sunset provision and a system of measuring success should be introduced. Fourth, instead of focusing on local content requirements, our industrial policy should be value chain oriented and should focus on specializations of those products in which we have a comparative advantage, so that we could achieve economies of scale.

This study's empirical findings are accompanying its qualitative conclusions. Empirical calculations reveal that the costs of SROs ($ 6.68 billion) surpass the advantages ($ 8.42 million), and the majority of respondents agree, citing more costs (restrict innovation, promote rent-seeking, erode competitiveness, promote monopolies, reduce tax revenue, and kill the level playing field in the economy) than benefits (substitution of imports, promotion of exports).

REFERENCES

Ahmad, K. (2020). In historic high, motorbike production and sales in Pakistan up by 70%. *Arab News PK*. Retrieved from https://arab.news/wnmgm

Ahmed, G., Khan, M. A., & Afzal, M. (2015). Trade liberalization and industrial productivity: Evidence from Pakistan.

Amhed, A. M., & Ather, R. (2014). Study on tax expenditures in Pakistan.

Ansari, U. (2020). 4 years of Auto Policy 2016-2021. Retrieved from https://carspiritpk.com/4-years-of-auto-policy-2016-21/

Aqil, M., Qadeer, S., Ahmed, R. R., & Qureshi, M. A. (2014). PROTECTION AND INDIGENIZATION LEVELS IN PAKISTAN AUTOMOBILE INDUSTRY FROM 1995 TO 2005. *International Journal of Engineering and Scientific Research 2*(4), 1-12.

Asian Development Bank. (2008). *Annual report*. Retrieved from the Philippines:

Bari, F., Afraz, N., Mukhtar, N., Khan, U., Fatima, U., & Hussain, S. T. (2016). *Regional Competitiveness Studies: Research Study on Auto sector*. Retrieved from Lahore:

Board of Investment. (n.d). Automobiles: sector brief. Retrieved from https://invest.gov.pk/automobiles

Choangalia, T. I., & Tabish, M. (2019). *Sector update: Trucks and busses sector*. Retrieved from https://docs.vis.com.pk/docs/TrucksandBusesSector201910.pdf

Choangalia, T. I., & Tabish, M. (2020). *Automobile sector*

Sector update. Retrieved from https://docs.vis.com.pk/docs/Automobile202008.pdf

EDB. (2021). *Duty & tax incentives for the manufacturing sector*. Engineering Development Board

Engineering Development Board. (2021). *Exports/imports statistics of engineering industry of Pakistan* Retrieved from http://engineeringpakistan.com/wp-content/uploads/2021/03/EXPIMPSTATSJUL-DEC-2019-20.pdf

Engineering Development Board (EDB). (2016). *Automotive Development Policy (ADP) 2016-2021*. Retrieved from http://engineeringpakistan.com/wp-content/uploads/2020/08/ADP-2016latest.pdf

Finance Division Government of Pakistan. (2021). *Pakistan Economic Survey 2020-2021*. Ministry of Finance Retrieved from http://www.finance.gov.pk/survey/chapters_21/PES_2020_21.pdf

Firpo, S. S. (2019, January 14). Automotive parts and accessories manufacturers en route for growth and double the investment. *Pakistan & Gulf Economist*.

Hanh, N. K. (2019). Impact of removing industrial tariffs under the European–Vietnam free trade agreement: A computable general equilibrium approach. *Journal of Economic Development*.

Haq, I. U. (2018, 28, October). Political economy of tax exclusions. *Daily Times*. Retrieved from https://dailytimes.com.pk/315374/political-economy-of-tax-exclusions/

JICA. (2011). *Project for Automobile Industry Development Policy in the Islamic Republic of Pakistan: Main Report*. Retrieved from

McD Team. (2022). Pakistan 2021. Honda shines in a fast recovering motorcycle market (+14.2%). Retrieved from https://www.motorcyclesdata.com/2022/01/20/pakistan-motorcycles/

Nasir, J. (2020). The tariff tripod of Pakistan: protection, export promotion, and revenue generation. *The Pakistan Development Review, 59*(3), 517-551.

Niazi, J., & Bhatty, M. M. J. I. o. P. P., Beaconhouse National University, Lahore. (2011). Study on Regional Value Chain: Case Study for the Automobile Sector.

PAMA. (2021). production and sales data of vehicles. Retrieved from https://www.pama.org.pk/wp-content/uploads/2022/03/production-sales-march-2022.pdf

Pasha, H. A., & Pasha, A. G.-. (2015). The Future Path of Tax Reforms in Pakistan. In *Moving the Economy Forward* (pp. 171): Cambridge University Press.

Punjab Board of Investment and Trade. (2018). *Analysis by Project and Policy Research Department: Automotive sector report*. Retrieved from https://pbit.punjab.gov.pk/system/files/Auto%20Sector_1.pdf

Pursell, G., Khan, A., & Gulzar, S. (2011). *Pakistan's trade policies: future directions*. Retrieved from

Qadir, U. (2016). Pakistan's automotive industry: a case of stalled development. *Pakistan Institute of Development Economics, 137*.

Ravi Magazine. (2017). *Analysis of the Pakistani automobile industry - a report*. Retrieved from https://www.ravimagazine.com/analysis-of-pakistani-automobile-industry-a-report/

Secretariat, W. T. O. (2015). *Trade Policy Review*. Retrieved from Pakistan https://www.wto.org/english/tratop_e/tpr_e/s311_e.pdf

Siddiqui, R., Iqbal, Z., & Kazmi, A. A. J. T. P. D. R. (1999). The Impact of Tariff Reforms on Income Distribution in Pakistan: A CGE-based Analysis [with Comments]. 789-804.

Singh, A. (2021). The two-wheeler industry in Pakistan. Retrieved from Pakistan Reader website: https://pakistanreader.org/view_PR_short_notes.php?url=Expanding%20population%20base%20with%20limited%20urban%20space%20necessitates%20the%20use%20of%20two-wheelers&recordNo=213

Tabish, M. (2021). *Industry risk analysis: Automobile*. Retrieved from https://docs.vis.com.pk/docs/Industryriskautomobile202111.pdf

Tauseef, S., & Raza, I. (2020). *Automotive parts: an overview*. Retrieved from https://www.pacra.com/sector_research/Auto%20Parts%20Sector%20PACRA_1603959365.pdf

Zia, U., & Mehmood, F. (2020). *Import and Export Policy Orders and Amendments Through Statutory Regulatory Orders* PIDE Islamabad. Retrieved from https://pide.org.pk/pdfpideresearch/kb-015-import-and-export-policy-orders-and-amendments.pdf