**National Tariff Policy**

**2019**

**(Draft)**

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**Commerce Division**

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# Introduction

Since FY2013, the GDP growth increased from 3.65% in 2012-13 to 5.8% in FY2018[[1]](#footnote-0), whereas, the exports posted a negative growth of 19% during 2014-17[[2]](#footnote-1) reversed in FY2018 with growth of 14%. The inverse trend between economic growth and exports in 2014-17 connotes that exports had not been participating in the economic growth. One of the major causes of decline in exports was the consistent increase in the proportion of trade-related revenue through multiple layers of tariffs and taxes; the industrial production has been rendered less competitive internationally, under the burden of higher tariffs. The tariff revenues increased by 169% during 2010-16, whereas imports grew by only 17% during that period. Regulatory duties have increased from 105 tariff lines in 2013 to over 1500 tariff lines at HS 8 in 2017; the share of collection from Regulatory duties in the import revenues increased from 1.5% to now more than 8% of the customs revenue collection[[3]](#footnote-2).

Effectively employed, the tariffs play an important role in allocation of resources, protection of the domestic industry against foreign competition, improving competitiveness of the domestic industry, generating employment opportunities, attracting and protecting investments, improving balance of payments, serving as a source of revenue and income distribution by levying higher import duties on luxury goods and lowering tariffs on raw materials and intermediate goods. On the other hand, employed excessively, the tariffs erode competitiveness of industry by increasing cost of inputs, cause de-industrialization by making industrial investment less viable due to eroded competitiveness, breed incompetence by protecting the inefficient producers, impose costs on consumers by making industrial products expensive, and create anti-export bias by making the domestic market more attractive than exports. The fact that the exports to GDP ratio went down from 13.5%in 2010 to 8.2% in 2017[[4]](#footnote-3), speaks volumes about the impact of higher tariffs on exports.

# Background

In Pakistan, the import tariffs have traditionally been employed as a revenue generation tool rather than instrument of trade policy as import tariffs are easy to levy and administer than direct taxes.

Pakistan had gradually liberalized tariffs, though with occasional increases in tariff protection from time to time. The number of general tariff slabs were gradually reduced from ten (10) in 1993 to six (6) in FY2015. The maximum tariff was reduced in FY2015 to 25%; on the other hand, 1% duty was imposed on the 40% tariff lines, mainly essential raw materials and machinery, which were hitherto exempted from duty. In FY2016, the number of slabs was further reduced to 5 and the maximum tariff was reduced to 20%; on the other hand, the lowest slab was increased from 1% to 2%. In FY2017, the slabs were reduced to four, by merging the slab of 2% and 5% and creating a new slab of 3%. It increased the import tariff on raw materials and machinery from 0% in FY2014 to 3% in FY2017. An additional duty of 1% was levied under SRO 1178(I)/2015, which was increased to 2% in FY2018. It made the duty on raw materials and machinery to 5% in FY2018 from 0% in FY2014.

The current four duty slabs are 3%, 11%, 16% and 20%, with a large number of tariff lines subject to additional duty of 2%.

|  |  |  |
| --- | --- | --- |
| **Duty Slab** | **No. of Tariff Lines** | **Value of Imports (US$ billion)** |
| 3% | 2,747 | 24.2 |
| 11% | 1,096 | 11.1 |
| 16% | 513 | 2.5 |
| 20% | 2,419 | 7.1 |

Regulatory duties also became another instrument for revenue generation in addition to the above-mentioned customs duties.

To facilitate the manufacturers-cum-exporters, a number of schemes are in place to waive/reimburse the import duty on their inputs; however the benefits of such schemes cannot be availed by all. Many exporters especially SMEs often fail to avail the benefits of such exemption schemes or duty drawbacks.

Besides, a large number of concessionary Statutory Regulatory Orders (SROs) and Customs General Orders (CGOs) were issued from time to time to provide concessions and exemptions. Realizing the complexity and distortions created by the SROs, efforts were initiated to phase out the concessions. However, instead of doing away with such concessions, a large number of those were moved to the Fifth Schedule of the Pakistan Customs Tariff.

# Issues in Tariff Regime

There are several factors responsible for the current tariff regime. One of those being the challenging situation of trade deficit which the country is facing now due to which the following main issues need to be addressed:

1. Employment of import tariffs as a revenue tool has created multiple distortions and affected the competitiveness of manufacturing, especially the export-oriented sector, as the cost of inputs and intermediate goods increase by higher import tariffs on the imported raw materials, intermediate goods and machinery.
2. The sustained high level of tariff protection creates inefficiencies in the manufacturing sector which is unable to protect its share in the domestic market, not to speak of competitiveness in the global market. It creates an anti-export bias as the producers of goods find export markets less attractive than the protected domestic market. The burden of the protection is borne by the domestic consumers since domestic prices for the protected items are maintained above international market prices.
3. Multiple duty slabs, high tariffs, concessionary SROs and regulatory duties keep the tariff structure complex which is prone to misuse through smuggling, under-invoicing and mis-declaration of quantity and quality of goods.
4. There are several raw materials on which there are different tariff rates for industrial and commercial importers for the same products. It makes the system prone to mis-declaration and creates distortions by disadvantaging the SMEs who cannot import raw materials themselves.
5. Frequent imposition of regulatory duties has made the tariff structure inconsistent and unpredictable, which hinders investment decisions.
6. The replacement of 0% duty slab, covering primarily the raw materials and machinery, with 3% slab (plus 2% additional duty) is adversely affecting the competitiveness of the manufacturing sector.

# Regional Trends

The experience of developing countries demonstrates that the pace of development in those countries, which have undertaken programs of structural reform, tariff rationalization and trade liberalization, was faster than the others. During the last decade, all the 20 fastest export-growth economies have reduced import tariffs; the two fastest growing economies have reduced tariffs by 72% and 51%, while in Pakistan the trend has been the opposite with an increase of 11% in import tariffs[[5]](#footnote-4). Additionally, the imposition of regulatory duties has increased the effective tariffs even higher.

Pakistan’s export growth since 2001 has been commensurate with the tariff liberalization. The applied weighted mean tariff in Pakistan was reduced from 20.62% in 2001 to 8.92% in 2014[[6]](#footnote-5). During the same period, exports increased by 173% from US$ 9.2 billion to US$ 25.1 billion. Since 2014, the tariff liberalization has been reversed by gradually increasing the applied tariff to 10.09%; the exports declined by 19% to US$ 20.4 billion[[7]](#footnote-6).

Currently, Pakistan maintains the third highest average weighted tariff amongst the 68 countries having more than US$ 20 billion annual exports. The import tariffs constitute 13% of the total tax revenues in Pakistan compared with the export driven economies e.g. Malaysia (1.6%), Turkey (2.0%), Indonesia (2.5%), South Korea (3.9%), Thailand (4.3%) and China (4.6%)[[8]](#footnote-7). The total revenue collection in Pakistan at the import stage is around 44% of the total tax revenues.

# Tariff Policy

## Objectives

National Tariff Policy 2019 aims to achieve the following objectives:

1. To **improve competitiveness** of manufacturing, including the export sector, through duty free access to imported raw materials by rationalizing the tariff structure;
2. To **increase employment opportunities** by attracting efficiency-seeking investment in the manufacturing sector by making tariff regime transparent and predictable;
3. To lessen the distortions in the domestic price structure and **improve consumer welfare** by reducing the burden of excessive protection;
4. To **remove anomalies in the tariff structure** which is causing distortions between sectors and in the value chain of the same sectors.

## Principles

The Policy is based on the following principles:

1. **Tariffs as trade policy instrument**

The tariff policy will be employed as an instrument of trade policy rather than revenue. The tariffs will be leveraged for creating the right balance between trade liberalization and time-bound protection.

1. **Simplification**

The tariff structure will be simplified by reducing exemptions and concessions.

1. **Cascading**

The principle of vertical consistency through cascading tariff structures (increasing tariff with stages of processing of a product) will be retained so that at any point in time, tariffs on inputs are lower than (or at least equal to) the tariff on the finished product. Besides, the steepness in escalation of tariffs will be reduced.

1. **Strategic Protection**

The domestic industry will be provided ‘strategic protection’ against the foreign competition during the infancy phase keeping in view the cost of doing business. The protection will be time-bound and phased out so as to make the industry globally competitive.

1. **Competitive Import Substitution**

The size of domestic market will be leveraged for development of competitive import substitution industry. The time-bound protection will be provided in the domestic market, which will be phased out to make the industry competitive for export-oriented production.

## Policy Guidelines

In order to achieve the above-mentioned objectives, the following tariff policy reforms will be undertaken:

1. These policy guidelines will be implemented gradually starting from the Budget 2019-20;
2. The tariffs slabs will be simplified based on the principle of cascading;
3. The tariffs on raw materials, intermediate goods and machinery will be gradually reduced;
4. The additional customs duty and regulatory duties on raw materials, intermediate goods and machinery will be reduced;
5. The difference in the rates of tariff for the commercial importers and the industrial users of raw materials, intermediate and capital goods will be eliminated to reduce misuse of such differentials and to provide access to such essential materials for SMEs.
6. The nascent industry will be provided time-bound protection, which will cover the payback period of financing and investment. The protection will be phased out gradually to make the protection regime predictable and facilitate the investment decisions. Such protection levels will be provided through Investment/Industrial Policy.
7. According to the Rules of Business, Tariff Policy is the subject of the Commerce Division. In order to implement these policy guidelines, the following arrangement will be instituted:
	1. A Tariff Policy Board (TPB) chaired by the Minister / Advisor Commerce and with Minister Industries & Production, Secretary Finance, Secretary Industries & Production, Secretary Board of Investment, Chairman FBR and Chairman NTC as its members shall be created. Secretary Commerce shall be the Member/Secretary of the Board. The TPB will be responsible for formulation, amendment and implementation of the National Tariff Policy.
	2. A Tariff Policy Centre shall be created in the Commerce Division which will serve as the Secretariat of the TPB.
	3. All proposals for levy, amendment or removal of tariffs including regulatory duties and customs duties shall be examined at the Tariff Policy Centre and after approval of the Tariff Policy Board shall be submitted by the Commerce Division to the Cabinet or Parliament, as the case may be, for approval.
8. Any policy impacting tariffs or having tariff-like impact shall be formulated through the process mentioned at (vii) above.

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1. Economic Survey of Pakistan, 2017-18 [↑](#footnote-ref-0)
2. Pakistan Bureau of Statistics [↑](#footnote-ref-1)
3. Federal Board of Revenue [↑](#footnote-ref-2)
4. World Development Indicators (World Bank) [↑](#footnote-ref-3)
5. World Bank [↑](#footnote-ref-4)
6. Ibid [↑](#footnote-ref-5)
7. Pakistan Bureau of Statistics [↑](#footnote-ref-6)
8. Ibid [↑](#footnote-ref-7)