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DO EXPORT FACILITATION SCHEMES DELIVER FOR PAKISTAN'S SMES?



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Abstract

The Government of Pakistan has offered export facilitation schemes to exporters with the objectives to lower trade costs and expand output. Currently, nearly one dozen export facilitation schemes are active. They also include those which are run by the Federal Board of Revenue (FBR). The question of 'effectiveness' of such schemes in boosting Pakistan's exports has remained a consistent theme of interest among policymakers, international development partners and private sector. This policy brief builds on a firm-level survey, conducted by the Sustainable Development Policy Institute (SDPI), and is an attempt to understand the effectiveness, overall gains, and shortcomings of four major export facilitation schemes offered by the FBR, including Duty and Tax Remission for Exports (DTRE), Manufacturing Bond (MB), Export Oriented Unit (EOU) and Export Facilitation Scheme (EFS). The study aims to provide insights on how best to improve design of Export Facilitation Scheme 2021, which will absorb all other schemes by the end of 2023.

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1. INTRODUCTION

Multiple export facilitation schemes exist in Pakistan with the latest one initiated in 2021. There have been recent improvements in these schemes, and it is important to see if early (intended) results have started emerging. We conducted the primary research to assess the impact of these schemes on the competitiveness of Small and Medium Enterprises (SMEs) exporting entities with the help of a firm level survey. Khaver & Ahmed (2023) believe that appropriately designed schemes can help reduce anti-export bias of other policies – something which we aimed to test with this research.

The FBR facilitation schemes assessed for exporting firms are as follows:

- Duty and Tax Remission for Exports (DTRE)
- Manufacturing Bond (MB)
- Export Oriented Unit (EOU)
- Export Facilitation Scheme (EFS)

In addition to the afore-mentioned four export schemes, the Government of Pakistan has rolled out dozens of schemes. The uniqueness of each scheme lies within the criteria and features, thereby being useful to businesses with varying needs. For instance, these schemes vary in eligibility, validity, utilization period, audit requirements, domestic sale, and purchase among others. However, the fundamental objective of these schemes remains the expansion of export volume, simplified documentation, and reduction in input costs. A detailed account of key characteristics and features of these schemes is provided in Annexure A.

The FBR had notified rules for the new Export Facilitation Scheme 2021 on 14th August 2021. This scheme is expected to continue with existing schemes like Manufacturing Bond, DTRE and Export Oriented Unit till they are phased out by the end of 2023 and will be replaced by EFS.

The survey was conducted during the period between May 2022 to July 2022 with the objective to bridge the evidence gap by providing an in-depth analysis to assess the effectiveness, benefits, and shortcoming of Federal Board of Revenue (FBR) facilitation in export space. Finally, some suggestions have been presented to improve the design of EFS 2021.

2. METHODOLOGY

Before conducting the survey, SDPI engaged the Ministry of Commerce, National Tariff Commission, Federal Bureau of Revenue (FBR) and other government departments to discuss the issue in detail. Gaps in literature were identified through an extensive literature review of government reports, minutes of meetings by relevant public sector entities and analysis by development partners.

The survey covered 300 respondents belonging to six prominent businesses having high concentration in Pakistan's exports, large-scale manufacturing, including textiles and garments, leather and leather products, agro and food processing, engineering goods, surgical instruments, and sport goods. A structured questionnaire was prepared to administer in Khyber Pakhtunkhwa, Punjab, and Sindh provinces. A conscious effort was made to get responses from current and potential trading firms and the firms owned and managed by women.

3. FINDINGS

Among all active exporters using FBR's export facilitation schemes as of 2022, over 95 per cent are availing these four schemes. As per 2022 FBR data, among all active manufacturers using different export facilitation schemes, 40 per cent are availing DTRE, 26 per cent are subscribed to MB, 24 per cent are using EOU, and only 9 per cent are utilizing EFS.

The schemes are available for those large-scale manufacturers, who directly import raw material. In some sectors, for instance, the surgical instruments manufacturer association said that less than 02 per cent firms are large enough or/and have working capital of PKR 80 million and above that can avail these schemes. For the other non-scheme utilizing exporting firms, commercial importers provide the raw material after which firms cannot apply for export schemes.

Key findings from the survey are provided below:

a. Top scheme, satisfaction level and perceived challenges

The most-subscribed export facilitation scheme among Pakistani exporters is DTRE, as two-fifths of all respondents in this survey reported using this scheme. A large majority of exporters using DTRE were satisfied with it, but they deem the cost of accessing it to be high. Besides, they also associated some growth in export volumes and some reduction in input and compliance costs with this scheme. However, the gains in export volume and cost minimization are small and do not offset the increase in other trade costs. In addition, some scheme-related and non-scheme related aspects are causing some discontent, mostly in areas of documentation, use of WeBOC platform and access to Pakistan Single Window (PSW). A buy-in from exporters, forwarders and banks during the planning, development and launch stages was missing, which contributed to industry's lesser familiarity with PSW. The government must reach out to the stakeholders to simplify and increase access to PSW.

b. Subscription for 'other' schemes

Three of the four studied schemes, i.e. MB, EOU and EFS, do not have DTRE's subscription level. There is a need to assess as to why the uptake of these schemes is comparatively low. The questions that need to be answered here are:

- Are these schemes highly targeted?

- Have exporters not been incentivized enough or made aware about the use these schemes?
- Is the application process to access/maintain these schemes more cumbersome than the process being adopted for DTRE?

More than 50 percent of respondents reported the input cost-minimization as below 10 per cent. This isn't a satisfactory level of cost reduction, especially considering the escalated input costs facing by the manufacturing and commercial exporters. This segment is also faced with a volatile currency value as well as tariffs and duties. A similar pattern of cost minimization of less than 10 per cent was observed across export schemes. Most respondents belonging to surgical instruments exporters availing DTRE said that they were not sure about the online availability of information and documents pertaining to this scheme. The same response was received from engineering goods exporters using MB. Likewise, most of the textiles and agro and food processing exporters subscribing EFS said that they did not easily find online information/documents for this scheme. It could be either due to limited outreach by the FBR, or lack of initiative by the exporters.

c. Recurring issues: matter of perception or reality?

The three issues that most exporters in our study sample identified again and again need to be addressed in the quest to improve the workings of the existing export facilitation schemes and eventual amalgamation into the EFS by the end of 2023. First, exporters have a dominant perception that FBR's facilitation schemes have a selection bias in favour of large industries. Second (a related concern), many exporters believe that the eligibility criteria for such schemes is 'tough'. Third (a usual issue), a lot of exporters said that the import process, including opaque customs clearance, is uncertain and time-consuming. These recurring, perceived issues facing the exporters need to be addressed to enhance the effectiveness of these schemes. The context is made even more critical considering that imports during the COVID era had become uncertain due to a host of issues requiring flexibility on the part of the FBR (Ahmed et al. 2021). More importantly, export schemes should be designed in a manner that may cater to and attract foreign direct investment in exporting sectors (Trade Development Authority of Pakistan [TDAP] 2020).

d. Refunds

Considering that over 80 per cent of all respondents in the sample reported facing significant delays in receiving tax refunds at import stage and given that this issue was

raised repeatedly by the participants on their own as well as during the fieldwork, it is critical to address this issue that morphs into a liquidity challenge. This issue severely constrains the cash flows and working capital of exporters, thereby raising their overall costs, and impacting competitiveness.

Exporters in several industries reported an increase in their export volume after accessing these schemes, but they said: those gains (mostly below 10%) are not enough. Any gains made seem to disappear in the face of long delays in import-stage tax refunds, which could take about four months for a sizable number of exporters studied in the survey. The issue of refunds severely constrains the cash flows and working capital of exporters, thereby raising their overall costs, and impacting firms' competitiveness. It is perceived that perhaps the predominant threat to the effectiveness of the FBR's export-facilitation schemes is the anguish faced by exporters on this count.

4. RECOMMENDATIONS

Some immediate measures are proposed that should be taken by the ministries of finance, commerce & industries, FBR, State Bank, SMEDA, PSW as well as business associations after conducting research with the help of think tanks.

- Credits should be provided in sales tax to resolve the issue of delays in refunds.
- Sector-specific public-private dialogues and assessments need to be conducted to understand in detail as to how the accessibility of EFS can be improved across current and non-conventional export sectors and how SMEs can access EFS better. For this purpose, firm-level data from PRAL will also be required by the team conducting these assessments.
- Furthermore, there is a need to conduct in-depth, sector-based studies exploring how delays in refunds have impacted the competitiveness of Pakistan's top exporting sectors over the years and whether any out-of-the-box technique may be applied to resolve this longstanding problem.
- An annual assessment of EFS should be conducted, published, and discussed with industry. This learning can then provide important corrective measures for the next round of improvements to the design and delivery of EFS.
- There is also a need to assess what kind of immediate and medium-term measures can be taken to address exporting firms' challenges in understanding systems at PSW.
- The government should allow evidence-based design and targeting under EFS, especially in pre-approval aspects of eligibility, outreach, and documentation in addition to mid-approval aspects of application such as processing timelines, issuance of necessary certifications & related process improvements, and automation.

5. CONCLUSION

Three main suggestions came out during our survey. First comes the expedient refunds, as this issue has direct financial consequences for exporters' working capital. The second one is linked to the PSW system, which exporters say needs to be immediately implemented in full, with its adoption raised to a high level in preferably a short amount of time. EFS processing should be a key component of PSW. PSW is a well-intentioned initiative that aims to cut trade costs. However, currently EFS is not completely linked with PSW. Most of the firms found the online interface complex and required time to provide feedback. The orientation to the industry about this initiative needs strengthening. Industry also cited that even banks, forwarders and carriers do not completely understand the PSW processes. Owing to such confusions, banks dealing with PSW have varying requirements for exporters thereby complicating or delaying operations.

The third suggestion pertains to documentation requirements, where exporters feel that the required number of documents could either be reduced, and if not, simplified enough for timely compliance. The clearance or approval time for documentation also requires a reduction. This entire process of accessing until approval of documentation related to EFS should be online.

There is a perception in the industry that the export facilitation schemes cater specifically to the needs of conventional exporting sectors. As larger information, networking, and learning costs are involved, therefore, only the established exporters are more likely to benefit from these schemes. There are calls within the private sector to reform the export facilitation schemes to facilitate non-conventional sectors, including the services sector such as in IT- and ICT-related segment (Economic and Social Commission for Asia and the Pacific 2021), agricultural products (Ahmed and Javed 2016), automobile (Ahmed and Batool 2017) and pharmaceuticals (Trade Development Authority of Pakistan [TDAP] 2022). Moreover, access to export facilitation schemes to smaller exporting firms and non-importing exporting firms remains a challenge.

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ANNEXURE-A

Scheme characteristics	DTRE	MB	EOU	EFS
i. Eligibility criteria for participants	- Manufacturer-cum-exporters - Commercial exporters with 15% value addition	- Manufacturer-cum-exporters	- Manufacturer-cum-exporters	- Manufacturer-cum-exporters - Indirect exporters - Commercial exporters - International toll manufacturers
ii. Validity	1 year	3 years	2 years	From 2-5 years
iii. Utilization Period	24 months	6 months	24 months	24-60 months
iv. Export target (as % of production)	100%	60%	80%	Not fixed; dependent on approval conditions
v. Allowed imports of input goods	All input goods/materials and services required for production of final product, accessories, trims. Also include: electricity, furnace/diesel oil for generation of electricity	All input material required for production of final product, such as accessories, sub-assemblies, sub-components, raw material, assemblies, and components. Also include diesel, coal, and gas.	All input material required, procured domestically or imported by EOU, sub-assemblies, equipment, sub-components, plant, assemblies, machinery, components and	Input goods means all goods whether imported or produced locally. Also includes energy sources such as coal, coke of coal, carbon blocks, diesel, furnace oil or gas

vi. Allowed imports of input goods	All input goods/materials and services required for production of final product, such as accessories, sub-assemblies, trims. Also include electricity, furnace/ diesel oil for generation of electricity	All input material required for production of final product, sub-assemblies, raw components, material, assemblies and sub-components. Also include diesel, coal and gas.	All input material required for procured domestically or imported by EOU sub-assemblies, equipment, sub-components, plant, assemblies, machinery, components, and apparatus, including capitalized goods. Also include electricity, furnace/ diesel oil for power generation	Input goods means all goods whether imported or produced locally. Also includes energy sources such as coal, coke of coal, carbon blocks, diesel, furnace oil or gas
vii. Domestic Purchase of Input Goods	Zero-rated domestic procurement of input goods allowed	Not allowed	Not allowed	Zero-rated domestic procurement of Input goods allowed
viii. Domestic Sale	Not allowed - only transfer is allowed to to other DTRE users.	Allowed up to 40%	Allowed up to 20%.	- Up to 20%: Allowed with duty payment. - More than 20%: Allowed with additional surcharge
ix. Regulatory Audit	Post-exportation audit within a period of 3 months after the expiry of DTRE approval	Periodical audit done at least once a year	Post-exportation audit is carried out at end of financial year	Audit takes place within 3 to 5 years, depending on category
x. Facility of Vendor	Disallowed implied	Allowed	Allowed	Allowed; Toll manufacturer also allowed