Withdrawal of Regulatory Duties: A Step Taken by the Government

Afsheen Naz

Policy Brief # 28
February 2012

A publication of the Sustainable Development Policy Institute (SDPI).

Sustainable Development Policy Institute is an independent, non-profit research institute on sustainable development.

Edited by: Ayesha Salman
First Edition: February 2012

Mailing Address: PO Box 2342, Islamabad, Pakistan.
Telephone + (92-51) 2278134, 2278136, 2277146, 2270674-76
Fax + (92-51) 2278135, URL: www.sdpi.org

Contents

Introduction

Pakistan is a developing country and has registered a very low growth rate (2.4%) according to the economic survey of Pakistan 2010-11. At present the country is suffering from massive internal crisis, both natural and manmade, and external pressures. To cope with the crises, the revenue generation side of the country has proved to be very weak. Due to these limitations the dependence on foreign loans has increased over a period of time. Heavy foreign debt is the major reason for Pakistan's loss of sovereignty.

Different measures have been adopted at various periods of time for the improvement in revenue machinery. The federal budget 2011-12 introduced many reforms including reduction in sales tax from 17% to 16% and broadening of the tax base. The revision of the federally announced policy in 2008 regarding the removal of regulatory duties (RD) is also amongst one of the announcements.

In 2008, 379 items were notified to bring in a regulatory duty net.[1]Most of the items which brought in the RD net consisted of edible items and some of them were machinery items. Two major reasons were identified for taking such an action at that time of which one was the reduction in import bill and other was volatile trends in international market prices.[2] However, the list of RD items was reviewed in 2009 and under the notification of SRO 482(I)/2009, a total of 397 items brought in RD net. These items were subject to the RD rate between the ranges of 10% to 50%.

In the current budget the list of 397 items has been reduced to 60 items under the notification of S.R.O.479 (I)/2011.[3] The decision of the government on the removal of RD is two fold; one to combat the smuggling of goods through the porous Pak-Afghan border and second to curtail inflationary pressure on the economy.

The current paper attempts to estimate the quantitative impact of the government's decision to remove regulatory duties on revenue collection, trade balance and domestic industry.

Specific data of the revenue generated by Regulatory Duties (RD) was difficult to obtain as the revenue figure is usually reported under the broad head of custom duties. Due to a dearth of exact figures, the figures used in the paper are based on reasonable approximation. Data on the 337 items, which are now RD free, has been collected with the help the website of the Federal Board of Revenue. However, data has been collected for the period of May-June 2010 to May-June 2011.

According to the collected data, it has been estimated that these items contributed approximately Rs. 5.65 billion to the total revenue of the country and comprised 3.99% of the total revenues generated under custom duty head during the period of one year. The removal of duty on these items is projected in a deterioration in balance of trade and revenue collection bill. Moreover, a move towards an "open" economy will severely affect the domestic industry.

---

[1] *"Impact of regulatory duty on luxury imports and revenue generation"* PITAD 2011
[2] The News, August 28, 2008
[3] Revenue Division, Ministry of Finance and Revenue, Government of Pakistan

1. Context of the Study

Regulatory duties are considered to be an additional part of customs. Basic motives for applying regulatory duties are;

(i) To regulate price structures and work towards attaining balance of payments
(ii) To protect and provide incentives to the domestic industry
(iii) To generate revenue

According to article 77 of the constitution of Pakistan, the decision of levying or removing of regulatory duty is the domain of the Federal Government of Pakistan. The Federal government in response to the international price trends set regulatory duty rates on certain goods. According to the Custom Act 1969, S.R.O.896 (I)/2008, the items which are imported under Free Trade Agreements (FTAs) and Preferential Trade Agreements (PTAs) are not subject to regulatory duty.

In 2007 the global financial crisis was observed. Additionally, increased food and energy prices on a global scale were also observed. Pakistan's economy, which was experiencing a stable growth in economic indicators during 2001 to 2007, was severely affected due to this global crisis. Consequently, revenues fell in the government's treasury which led to the balance of payment crisis. Subsequently, the value of the rupee depreciated and the inflation rate increased. A frequent usage of the term 'Panic Protectionism", among trade specialists was seeing during 2008.[4]

The government of Pakistan took the decision of levying regulatory duties to cope with the balance of payment crisis. The IMF prepared a rescue package for Pakistan. The result of the rescue package was that 379 items were brought under the subject of RD where the RD rate was applied. The action was done without violating WTO rules as "*the WTO regime allows its member countries to impose regulatory duties temporarily on their imports, if faced with macroeconomic and BOP shocks*"[5].The regulatory duty on imported food items helped to keep the market for domestic produce afloat. Most of the items under RD head were food items. Nevertheless, some luxury vehicles were also brought under the list.[6] However, this list of 379 items enhanced in 2009 and a total of 397 items were brought under the RD net.

The action of 2008 has been reversed by the federal government in the current year. At present, many of the items have been exempt from Regulatory duties. The list of 397 items has been reduced to 60 items under the notification of S.R.O.479 (I)/2011.[7]However RD on luxuries items like cars have not been withdrawn.

In the budget 2011-12, while taking different budgetary measures related to customs, various policy objectives have also been announced. These policy objectives include; Equity in tax system, industrial incentives for growth and expansion through reduced cost of raw materials, tariff rationalization to facilitate trade, amendments in legal provisions to remove arbitrage and

[4]*Ibid*, page 01
[5]*Ibid,* page 01
[6] Note: List of products subjects to Regulatory Duties in August 2008 can be reached under annexure 01
[7] Note: List of continual regulatory duty items can be reached under annexure 02

ambiguity and export promotion.[8] Whereas, "removal of regulatory duty, particularly on edible items" come under "relief measures" head of the Customs Budgetary Measures 2011-12.

In the federal budget, other than squeezing RD net, an ambitious increase of 11% in net revenue receipts has been projected in comparison with net revenue receipts of last year. On the contrary, in Pakistan, out of a population of 180 million only 2.8 million individuals are registered for income tax while only 1.5 million actually pay taxes, whereas, about 2.3 million people have been proposed to be brought under the tax net in the current fiscal year.[9]

2. Objective of the Study and Database

The focus of the paper is to analyze the impact of withdrawal of regulatory duty on 337 items on the revenues, trade balance and domestic industry of the country. A period of May 2010 to May 2011 has been selected, to collect the data on cumulative values as well as respective generated revenues on these 337 items.

The record of revenues generated by regulatory duty items is hard to find as it is merged in the head of "Customs", therefore a self-collection of the data was applied. Whereas, to collect the data, relevant Pakistan Customs Tariff (PCT) Codes of the items were identified. For acquiring the appropriate and authentic data, help from the website of Federal Board of Revenue was taken.

All the data collected on items is in US Dollars. However, conversion of the dollar into rupees has been used during the analysis. According to the Economic Survey of Pakistan 2010-11, the average rate of dollar to rupee in 2010 remained Rs.85.3. The same average has been used in the paper for the conversion purpose with the assumption of *CeterisParibus.*

3. Analysis

According to estimation, the total money Rs. 81.49 billion was spent on the import of 337 items, during the period of one year. The import of these items is not concentrated from one country but from various countries. It has been estimated that under the regulatory duty head these items contributed revenue of Rs.5.65 billion[10] during the same period of time.
The items on which data was collected under the study can broadly be categorized under these heads;[11]

(i) Butter, Other Fats and Oil
(ii) Fruits (Fresh and Dried)
(iii) Sausages and Meat
(iv) Cane Or Beet Sugar And Chemically Pure
(v) Malt Extract; Food Preparations Of Flour
(vi) Pastas
(vii) Vegetables and Other Eatables

[8] FBR, Customs Budgetary Measures 2011-12
[9] Text of Federal Budget 2011-12 Speech delivered by DR. ABDUL HAFEEZ SHAIKH (Geo TV)
[10] Note: the collected revenue excludes revenue generated under PCT code of 8517.1210-cellular phone head, due to non availability of data
[11]Complete list of items along with RD rates can find at; *dartways.com/uploaded/laws/2008sro896.pdf*

(viii) Waters, Including Natural or Artificial
(ix) Essential Oils (Terpeneless Or Not)
(x) Soap; Organic Surface-Active Products
(xi) Worked Monumental Or Building Stone
(xii) Sheet Pilling of Iron or Steel
(xiii) Padlocks and Locks
(xiv) Nuclear Reactors; Fuel Elements (Fans)
(xv) Electric Motors and Generators
(xvi) Seats
(xvii) Worked Ivory, Bone, Tortoise-Shell
(xviii) Polymers of Ethylene, In Primary Forms
(xix) Uncoated Paper and Paperboard
(xx) Refractory Bricks, Blocks, Tiles and
(xxi) Glass in Balls (Other Than Micro-spheres)

The money spent on fruits (fresh and dried) is Rs.1.3 billion, similarly it adds up to a total of 3.33% in total RD revenue. Similarly, the head of "vegetable and other eatables" comprises spending of Rs. 0.28 billion which embraces 0.98% of total RD revenues.

3.1 Impact on Revenues

The net revenue receipt of the country comprises of four major heads (i) Direst Taxes (ii) Sales Tax (iii) Federal Excise Duty and (iv) Custom Duty. Total revenue of Rs. 1588 billion has been collected during the fiscal year 2010-11, that is actually the revised target of Rs. 1,667 billion which was set in budget 2010-11.[12] According to FBR reports the custom duty head adds up to Rs.141.60 billion in total revenues. Whereas, the self calculated revenue from regulatory duties, during the aforementioned period, is of Rs. 5.65 billion.

Table: 3.1 Revenue collections under CD and RD Heads: Rs. In billion

Period	**Custom Duty Revenues (CDR)**	**Regulatory Duties Revenues (RDR)**	**% of Custom Revenues**	**Revenue Loss (CDR-RDR)**
May-June 2010 to May-June 2011	141.60	5.65	3.99%	137.61

If trends of importing of these items remain same in current fiscal year, then a revenue loss of Rs.5.65 billion can be projected in the government's treasury. Hence, a rise in the deficiency of the government to meet the set revenue targets can also be projected. This will lead, again, to repeating the history of revising set targets. Historically, set revenue targets have often not been achieved but revised, for instance in budget 2010-11 a total of Rs.1,667 revenues were target but during the fiscal year the revenues were revised and collected at Rs.1588 billion.

The revenue generated under the RD head is also calculated in a report *"Pakistan's Trade Policies: Future Directions"* by Pursell et al. (2011). The report talked about the abolishment of regulatory duties but also suggests adopting certain substitutes to fill in

[12] FBR, Pakistan

any gaps. For instance, the levying of equivalent ad valorem excise duty in the replacement of regulatory duties on same products was suggested in the report. On the contrary, in the current budget no alternate policy was announced to combat the revenue loss or protected economy in the result of announced policy.

Despite the fact that certain measures have been adopted in the budget 2011-12 to enhance the tax base but without proper planning to combat the revenue loss occurred through withdrawal of regulatory duties; the gap may not be filled or may be partially filled. The hypothesis can be strengthening with the fact that the country is passing through the same issues which were experienced in the previous year. Unfavorable conditions i.e. due to natural calamities such as the floods, the energy crisis and security issues are still present in the country. This results in the projection of loss on the revenue generation side.

Moreover, the government's step in the current year of empowering the provinces can also be considered in the wake of revenue collection or contraction. Provinces are proposed to generate a share of Rs.1, 203 billion in net revenue receipts in the current fiscal year 2011-12. At the same time, all the four provinces were expected to present a surplus of Rs.124.88 billion in their provincial budgets 2011-12, which comprised of 5% of the total revenues. On the contrary, not a single province was able to present surplus in their budgets.

Although, the revenue generated by regulatory duties in the said period is not a wide-ranging contribution towards overall revenues of the country, without initiating or announcing an alternative, such decisions proved to be harmful.

3.2 Impact on Trade Balance

The country's trade always presents a dismal picture as the trade deficit has been registered in most of the period of the time. The trends in trade deficit have, however, changed with periods of time. The trade deficit in the first ten months of the year 2010-11 recorded at $ 8,285 million where exports and imports during the same period were recorded at the amount of $ 20,526million and $ 28,811million respectively.[13]

According to the Economic Survey of Pakistan 2010-11 imports of the country grew by 14.7%, which amounts for $4.1 billion, in the period of July10-April11 in comparison with the same period during last year. There were two reasons for this; higher global crude oil and commodity prices have been identified behind such rise in imports in the economic survey. Import of food items has been categorized as the second most imported item during the same period of time, whereas machinery items are the first most imported items. The import in food items contributed $ 1,528 million in import bills which is 13.4% of total imports, the economic survey states.

Hence the trade balance is further projected to deteriorate due to lifting up of RDs on food items. A further rising trend in food items can be envisaged which could prove to be harmful for the balance of payment.

[13] Economic Survey of Pakistan 2010-11

3.3 Impact on Domestic Economy

The consequences of such instances could also possibly be seen on the domestic markets of such products. The dependence on international markets will increase more which will not let the economy, even being an agrarian country, be a food independent country as import of food items are already contributing in very high ratio of 13.4% in total imports of the country.

Most of the regulatory duty free items come under the category of consumer goods especially household appliances and processed food (Pursell et al. 2011). According to the same IGC report, almost all of the regulatory duty items are produced in Pakistan. Hence, domestic producers were highly protected. These industries are no longer vulnerable.

After lifting up the protections, the non-competitiveness of the domestic industry is a considerable factor as it would not compete with the low prices hence will be captured by international competitors who are comparatively cheaper and more efficient. This non-competitiveness can be attributed with the presence of many unfavorable factors. Improper production environment in the wake of high input cost, fundamental-old production methods, heavy dependence on natural resources i.e. water, high cost of doing business, energy outages, perilous security situation, negative advisories etc. are amongst such factors which do not allow the domestic industry to grow in a proper manner. In the backdrop of this scenario, lifting up the protection rates on the majority of the items fall under RD and particularly fruit and vegetables, will definitely result in severe losses to the economy.

Moreover, shutting domestic industries will end harming the economy of Pakistan in multiple ways. A rise in trust breakage of the investors and unemployment are major side effects of such openness of the economy. Such negative outcomes of the trade liberalization i.e. loss to industry, production, employment and moreover loss to firm specific human capital, have been identified by Matusz and Tarr (1999) in their study "Adjusting to Trade Policy Reform". This cycle of effectees will go on in the absence of opting proper measures to wisely handle such decisions.

4. Recommendations

The Governments should adopt different measures to combat certain issues faced by the country so that well-built economic growth can be attained. Polices should be aligned with adopted measures. Sustainable economic growth can only take place if the internal side of the economy is strengthened while controlling structural weaknesses.

Despite abolishing all the RDs, partial abolishment should have been adopted. The country is and has been suffering from uncertain internal and external shocks that severely affect the economy. Lack of proper planning to cope with and to manage uncertainties, is the major reason which has stopped the country from taking major steps for the betterment of the economy. An abrupt step like abolishing RDs can prove to be harmful in case similar situations of the past are repeated. This is so because the economy of Pakistan is vulnerable to internal and external shocks.

The partial abolition of regulatory duties also fits into the suggestion posed by Pursell et al. (2011). It has been argued in the report that the production of high cost import substitutions will increase more in the country if RDs prolonged. Against this backdrop, a partial removal will end with little competition. This will result in production of normal cost import substitutions.

Above all, if full abolishment was planned to be done, alternatives such as are suggested by Pursell et al. (2011) would have to be adopted i.e. replacement of current regulatory duties with equivalent ad valorem excise duty on the same products. This will serve as protection and will result in avoidance of any sort of abrupt shock to the domestic producers as well as to the government treasury.

The global financial crisis can again be foreseen in the future as for the first time, America has experienced a dip in credit rating from AAA to AA+. Hence, careful insight is needed before taking any step.

The country is heavily indebted with foreign loans. The debt is given on the proviso by foreign creditors on imposing certain limitations. Some of these conditions are very tough for the growing economy of Pakistan, for instance, the condition of increasing gas prices and withdrawal of subsidies. In the presence of such an unfavorable environment for investment and production and even for sustenance of the present industries, the action of opening the economy without providing proper protection to the domestic industry will definitely further harm it.

Although different vigilant steps have been announced in the current budget for generating and eventually enhancing revenues, again domestic uncertainties matter. Lack of political will along with political unrest, the presence of the element of lack of coordination between government institutions and problems in administering any issue properly, are amongst those domestic issues that can prove as hurdles in the successful implementation and completion of any strategy.

Instead of completely opening the economy to foreign products, domestic producers should be strengthened. Incentives in the wake of availability of the investment environment should be provided to the local producers so that the supply side of the economy is enhanced. With an increase in domestic production it is hoped that there will be less need for imported products.

Through increasing domestic production the demand and supply gap can be filled which would also control smuggling. Consequently, some sustainable improvements in trade balance and balance of payment can be achieved.

Annexure 01

Products subject to regulatory duties August 2008

HS	Product Type Affected
04	Dairy Products
08	Fresh Fruits
16	Meat Preps
17	Chewing Gum etc.
18	Processed Cocoa Cola
19	Processes Grains (pasta etc.)
20	Processed Vegetables. Fruit Drinks etc.
21	Sauces, Soups etc.
22	Soft Drinks
23	Dog & Cat Food
24	Tobacco Products
33	Toilet Preps-Shampoos, Toothpastes etc.
34	Toilet Soaps etc.
68	Granite, Marble etc.
69	Ceramic & Porcelain Household Products
73	Cooking Household Appliances
83	Pad Locks
84	Machine-mainly household…refrigerators, fans etc.
85	Electric Machines-mainly households-toaster, TVs Etc.
87	Cars & Jeeps>1801 cc
93	Weapons (revolvers etc.)
94	Household Furniture
96	Miscellaneous

Source: Pakistan's Trade Policies: Future Directions (2011) Garry Pursell, Ashraf Khan and Saad Gulzar for the International Growth Centre, Lahore

Annexure 02

Continual RD Items:

S.No	PCT Code	Description	Rate of regulatory Duty
1	0802.9010	Betel Nuts	10% ad valorem
2	1005.9000	Maize If imported from India	25% ad valorem
3	2402.1000	Cigars, cheroots and cigarillos, containing tobacco	15% ad valorem
4	2402.2000	Cigarettes containing tobacco	15% ad valorem
5	2402.9000	Other	15% ad valorem
6	2403.1000	Smoking tobacco, whether or not containing tobacco substitutes in any proportion	15% ad valorem
7	2403.9100	Homogenised" or "reconstituted" tobacco	15% ad valorem
8	2403.9910	Tobacco for chewing	15% ad valorem
9	2403.9990	Other	15% ad valorem
10	6907.1000	Tiles, cubes and similar articles, whether or not rectangular, the largest surface area of which is capable of being enclosed in a square the side of which is less than 7 cm	15% ad valorem
11	6907.9000	Other	15% ad valorem
12	6908.1000	Tiles, cubes and similar articles, whether or not rectangular, the largest surface area of which is capable of being enclosed in a square the side of which is less than 7cm	15% ad valorem
13	6908.9010	Tiles	15% ad valorem
14	6908.9090	Other	15% ad valorem
15	6910.1010	Wash basin	15% ad valorem
16	6910.1020	Bath tubs ceramic	15% ad valorem
17	6910.1030	Bidets ceramic	15% ad valorem
18	6910.1040	Cisterns ceramic	15% ad valorem
19	6910.1050	Sink ceramic	15% ad valorem
20	6910.1060	Toilet ceramic	15% ad valorem
21	6910.1070	Urinals ceramic	15% ad valorem
22	6910.1080	Water loset pans	15% ad valorem
23	6910.1090	Other	15% ad valorem
24	6910.9000	Other	15% ad valorem
25	6911.1010	Dinner sets	15% ad valorem
26	6911.1020	Dishes	15% ad valorem
27	6911.1030	Dishes	15% ad valorem
28	6911.1030	Tea cups and saucers	15% ad valorem
29	6911.1090	Other	15% ad valorem
30	6911.9000	Other	15% ad valorem

31	6912.0010	Tableware and kitchenware	15% ad valorem
32	6912.0090	Other	15% ad valorem
33	6913.1000	Of porcelain or china	15% ad valorem
34	6913.9000	Other	15% ad valorem
35	6914.1000	Of porcelain or china	15% ad valorem
36	6914.9000	Other	15% ad valorem
37	8703.2329	Cars and Jeeps 1801 cc to 3000cc (except	50% ad valorem
		electric hybrids)	
38	8703.2490	Cars and Jeeps above 3000 cc (except	50% ad valorem
		electric hybrids)	
39	8703.3229	Cars and Jeeps above2000 cc (except	50% ad valorem
		electric hybrids)	
40	8703.3390	Cars and Jeeps above2500 cc (except	50% ad valorem
		electric hybrids)	
41	8703.9000	Other (except electric hybrids)	50% ad valorem
42	9302.0092	Pistols, single barrel, semiautomatic or	15% ad valorem
		otherwise	
43	9302.0093	Pistols, multiple barrel	15% ad valorem
44	9302.0099	Other	15% ad valorem
45	9303.1000	Muzzle loading firearms	15% ad valorem
46	9303.2011	Pump action	15% ad valorem
47	9303.2012	Semiautomatic	15% ad valorem
48	9303.2019	Other	15% ad valorem
49	9303.2020	Shotguns, multiple barrel, including	15% ad valorem
		combination guns	
50	9303.2090	Other	15% ad valorem
51	9303.3010	Single shot	15% ad valorem
52	9303.3020	Semiautomatic	15% ad valorem
53	9303.3090	Other	15% ad valorem
54	9303.9000	Other	15% ad valorem
55	9304.0000	other arms (for example, spring, air or gas	20% ad valorem
		guns and pistols, truncheons), excluding	
		those of heading 93.07	
56	9306.2100	Cartridges	15% ad valorem
57	9306.2900	Other	15% ad valorem
58	9306.3010	Cartridges for riveting or similar tools or for	20% ad valorem
		captive bolt human killers and parts thereof	
59	9306.3090	Other	15% ad valorem
60	9306.9000	Other	20% ad valorem

Source: Ministry of Finance, Federal Board of Revenue, Government of Pakistan
(http://o.fbr.gov.pk/budget2011-12/Notifications/Customs/SRO.479%28I%29-2011.pdf)

References

Akhtar, S, Zafar, S & Rizwan A 2011, *Impact of regulatory duty on luxury imports and revenue generation: Analysis of Monthly Data July2007-June2009*, PITAD, Islamabad, Pakistan

Economic Survey of Pakistan 2010-11

Federal Board of Revenue, Revenue Division, Government of Pakistan
<www.fbr.org>

Federal Board of Revenue, Customs Budgetary Measures 2011-12
<http://o.fbr.gov.pk/budget2011-12/SalientFeatures/SALIENTFEATURES%28CUSTOMS%29.pdf>

Matusz S and Tarr D 1999, *Adjusting to Trade Policy Reform* World Bank Policy Research Working Paper No 2142 Washington, DC, World Bank.

Pursell, G, Khan, A & Saad Gulzar 2011, *Pakistan's Trade Policies: Future Directions,* International Growth Center, Lahore, Pakistan

The News, August 28, 2008

Text of Federal Budget 2011-12 Speech delivered by Dr. Abdul Hafeez Shaikh
<http://www.geo.tv/important_events/2011/budget2011/pages/budget_text_eng.asp>