Youth Economic Forum

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Analysis of Pakistan's Tariff Policy 2019-24

Pakistan currently has four tariff slabs ranging from 3% to 20% effective on 6,775 tariff lines with additional duties of up to 7% on numerous tariff lines and many concessionary Statutory Regulatory Orders (SROs) and Customs General Orders (CGOs). Tariff policies play an important role as a trade policy tool but Pakistan primarily employs it as a revenue generation tool. This was a significant tool to raise revenue for the governments all around the world when property taxes and income taxes were not as common as trade taxes, but now it is considered unfeasible due to the inequitable tax effects as well as the distortionary effects on global prices in case of countries whose trade policy effects the global economy. However, developing countries like Pakistan use tariffs for revenue generation since they are easier to assess and collect compared to other forms of taxation which require a broad base and active regulation for significant revenue collection. This has led to distortionary effects on prices and increased input costs which has adversely effected manufacturing. Moreover, the aim to generate revenue has led to increased tariffs and the current high tariff rates of Pakistan compared to its neighboring countries has led to a significant decrease in the country's share in the global market regardless of the overall increase of the Asian region. Another major problem for Pakistan due to its current tariff regime is the anti-export bias, which has basically decreased the local producers' willingness to export, since their competitiveness is eroded by the high level of protection. The current tariff policy has also increased mis-statement by underpricing goods which has sustained due to the complicated tax regime with multiple slabs, SROs and CGOs whereas the uncertainty created by regular reforms in the taxation system hinders investment. Overall tariffs decrease welfare as shown by the three-year Strategic Trade Policy Framework carried out by the government of Pakistan in 2015. It failed badly as the desired unrealistic outcome was never achieved putting a dent on an already slow growing economy. The objectives included strengthening of annual exports to US$ 35 billion and improvement of export competitiveness. High tariff rates and regulatory duties on numerous goods isolated Pakistan from the global markets and the regulatory duties that were put in place to collect more taxes, extra revenue and restrict imports had adverse effects as smuggling route took over the legal trade route.

The Commerce division of Pakistan is supposed to use tariffs in order to safe guard their domestic markets, reduce inequality in income distribution, reduce distortionary effects of prices, reduce unemployment and inhabit comparative advantage but the FBR has been influential in increasing tariffs to cover the gap formed by low tax revenues. The National Tariff Policy 2019-24* has acknowledged the persisting problems and devised ways to counteract the problem. Their objectives and principles include simplifying tariff structure, reducing tariffs, increasing employment and strategic protection.

The objective of simplifying the tariff regime in order to increase its operational efficiency is essential for reducing anomalies caused by tariffs. Moreover, reducing tariff rates to increase manufacturing and support consumers is an essential objective since it has been proven from past trends that reduced protectionism in Pakistan leads to improved consumer welfare, increased investment and an increased share in the global market.

However, one of the major issues for Pakistan's economy has been strategic protection of industries which is listed as an objective of the Tariff Policy 2019-24. Based on the infant industry argument, strategic protection aims to temporarily protect an industry in its early stages using tariffs until it expands its production capabilities and can compete in the global market. Although this argument seems plausible to increase the productivity of countries, it is complicated and has been an opportunity of exploitation for industries in Pakistan. Identifying industries that will foster a comparative advantage and when to reduce tariffs is ambiguous and difficult to deduce. Hence, as a result, inefficiencies increase in the economy since the positive spillover effects of free trade in terms of competitiveness and knowledge is being stopped from entering the country too. An example of this is the Pakistan automobile industry which flourished considerably during the first few years of protectionism but was not competitive enough for the global market and has currently become an oligopoly of sorts; extremely expensive for the consumers and highly uncompetitive. Although when implemented and regulated, protectionist policies may help countries for example, it benefitted US when USITC granted Harley Davidson temporary protection which resulted in the firm becoming a motorcycle exporter. But for a country like Pakistan, strategic protection is often exploited by firms to increase their market share without producing long-term gains for the economy hence the objective may not be feasible.

Another major concern in the tariff policy objectives is the use of tariff policy to reduce unemployment. There are certain implications of buffering a sector's employment through tariff including reallocation of resources from other industries which may lead to reduced productivity or even shutting down of those industries. Another concern regarding this policy is that welfare losses can be minimized using subsidies to employ more people in that certain industry. However, it is important to note that economists believe monetary and fiscal policy tools should be used to battle unemployment since both tariffs and subsidies create significant inefficiencies. Using tariffs to reduce unemployment, considering the current situation of Pakistan's tariff structure, may be over-ambitious and unrealistic.

The objective of simplification of tariff policy using the cascading method may be problematic due to the high degree of illegal practices, such as smuggling and under-stating prices, already prevailing. Misstating the use of the import in the supply chain to reduce the tariff on the import might become popular and further increase inefficiencies in the tariff regime.

Considering Pakistan engages in extensive bilateral trade with China, the trade policy of Pakistan lacks the objective of using protectionism to reduce international policy distortions such as dumping and foreign subsidies which lead to efficiency losses in the home country. For example, dumping is the practice of lowering export prices compared to domestic prices which causes a huge influx of goods in the importing country. Hence to counter this distortion, an anti-dumping duty is applied to increase the price of the import that is being "dumped". Another distortion is the foreign subsidy given to domestic producers which causes a hike in domestic prices. This can be counteracted by the imposition of a tariff called a countervailing duty (CVD), equal to the amount of the subsidy, offsetting the price increase in the domestic market. US employs protectionism to counteract dumping and foreign subsidies, for example, at one point in 2012 the United States International Trade Commission (USITC) had 50 CVDs with China, facing the highest frequency on 23 goods and 242 antidumping duties on goods from 37 different countries with China being the highest bearer of duties on 92 goods. Considering Pakistan carries out a huge chunk of bilateral trade of around US$20 billon with China and it is expected to increase due to the "China Pakistan Economic Corridor" under the "One Belt One Road", a tariff regime to counteract distortionary effects of international policies are integral for sustenance of the domestic market.