PROTECTION AND INDIGENIZATION LEVELS IN PAKISTAN AUTOMOBILE INDUSTRY FROM 1995 TO 2005

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ABSTRACT

The automobile industry in Pakistan is one of the most significant sectors in large scale manufacturing industries. The industry was given protection against the foreign competition up to a large extent. This paper gives a detailed analysis on degree of protection from 1995 to 2005. In addition to this, it studies the level of indigenization the automobile firms achieved over a period of time. The investigation reveals that despite the high degree of protection, the industry could not achieve the deletion objectives as set by the authorities. Therefore, this is inevitable to review the policy and set new objectives.

***Key Words:* Automobile, Indigenization, Protection, Deletion, industry**

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1. BACKGROUND

Automobile industry is one of the important industries in large scale manufacturing sector of Pakistan. The history of the industry started when General Motors and Sales Company was established in 1949. Bedford truck was the first vehicle which was assembled in the country. After tha, many other firms entered the market and the industry grew rapidly during pre-nationalization period. In 1970s, the industry was nationalized along with many other industries. Though, the nationalization period proved to be a good era for auto sector, the size of state-owned enterprises expanded to an unmanageable extent. Therefore, there was a demand for privatization.

During the regime of Gen.(r) Ziaul Haq, the process of denationalization and deregulation started. Although the efforts were more directed towards political benefits, they opened the door for for foreign investment and liberalization of the industrial sector. During 1990s, the privatization process started and eight out of fifteen automobile units were sold out to private sector. That privatization brought about many positive and negative changes in the auto industry. The policies of government exposed the industry to open market competition when it allowed zero-rated import of cars under the Yellow-Cab scheme. As a result, the output of vehicles declined drastically from 65,000 units per year to 45,000 units per annum. The positive aspect of privatization was the entry of foreign firms.

The industry struggled a lot during 1995-2000. However, the post 2000 scenario was good as the sector got many the supporting factors to boost up the industry. These factors included the availability of auto finance, rise in foreign remittances, rapid economic growth and the efforts made by the government. The industry experienced a very high growth rate from 2001 to 2005. However, the growth process was interrupted by tight monetary policy, political instability and decline in home remittances.

2. PROTECTIONISM IN PAKISTAN

The automobile industry of Pakistan had been well protected by means of tariff and non-tariff barriers. The objective of this protectionism was to enable the industry to achieve the desired level of indigenization. Following is the analysis of protection policy of the industry from 1995 to 2005.

2.1 History of Protection Policy

The industrial sector in Pakistan had been protected against the foreign competition immediately independence. This protectionism continued even during 1995-2005. The authorities imposed various tariff and non-tariff barriers. In addition to this, the import of new or used vehicles was discouraged by high import duties. Nevertheless, in 1990, the government started liberalization process when Mr. Nawaz Sharif announced the Yellow Cab Scheme. The industry could no able bear the shock of open competition. As a result, the government was once again forced to take measures to protect the industry. The steps included imposing a ban on import of used cars, charging high rate of custom duty on Completely Built Units (CBU) and the creating a gap between the duty structures of CBU and CKD kits. The same policy carried on with some minor changes till 1994. After 1994, the Economic Committee of Cabinet (ECC) decided to reduce the import duty on CKD units of 1000 cc, 1300 cc and 1600 cc from 40% to 10%. However, the committee suggested carrying on the complete ban on the import of used cars which were older for two or more years. In addition to this, a 25% depreciation allowance on second hand cars was also withdrawn. In 1995, the tax rate on CKD and CBU was also simplified. Different categories of import duties and taxes were converted into one category of duty to 30% on CKD and assembled vehicles. Sales tax at the rate of 15% was imposed on the total cost. On the other hand, the minimum import duty on CBU of 1000 cc was set to 100%.

2.2 Import of Used Vehicles

Theoretically, the import of new or used vehicles was not banned in the country during 1995-2005. In practice, however, the high tariff structure discouraged the importers. So, the imports of completely built up units became very difficult. The issue for importing used cars had been a very debatable topic in the country since the introduction of Yellow Cab Scheme.

2.3 Tariff Barriers

Tariff barrier is a very effective conventional tool against the competition of foreign manufacturers. Although, the tool was losing its effectiveness in a post WTO scenario, the custom duty had been sheltering the domestic Original Equipment Manufacturers to a great extent. However, the government kept on reducing tariff barriers from 2001 to 2005 in compliance with the WTO regulations.

TABLE-1: Custom Duty on Cars

New Passenger Car	2001-02	2002-03	2003-04	2004-05
1801 cc ~	250%	200%	150%	100%
1601~1800 cc	150%	125%	125%	80%
1501~1600 cc	150%	100%	100%	70%
1301~1500 cc	150%	100%	100%	100%
1001~1300 cc	120%	100%	100%	50%
~1000 cc	100%	75%	75%	50%

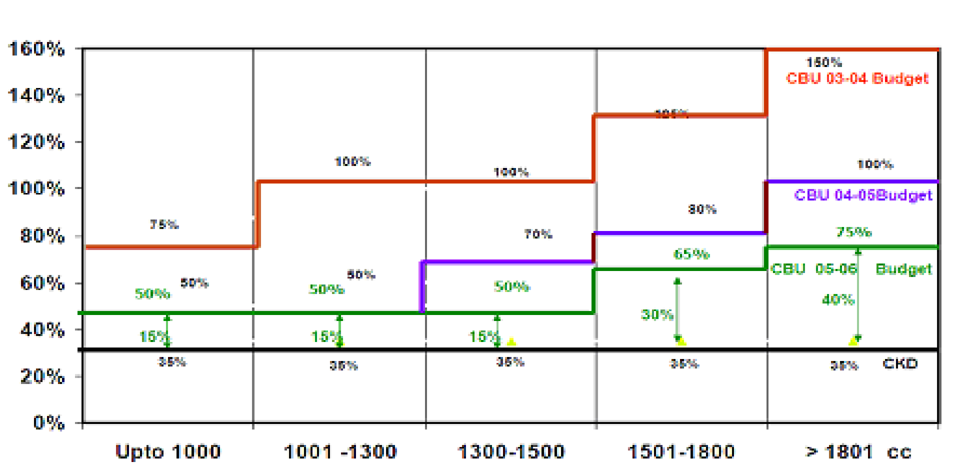
Source: Pakistan and Gulf Economist, 2005”

The above table reveals the declining trend in the custom duty on Completely Built Up units for different engine capacities. This reduction in import duty was not welcomed by the local assemblers as that would have a negative impact on the local industry. Due to the declining trend in tariff rates, the industry was prone to open market competition with the foreign assemblers.

2.3.1 Duty Gap between CKD and CBU

The duty structure for Completely Knocked Down and Completely Built Up units was different for obvious reasons as displayed by the following figure:

Figure 4.1 CKD and CBU duties difference in Pakistan



Source: Indus Motors, 2005

So, the policy makers attempted to discourage the import of vehicles and encouraged the localization of parts. However, the government had a tendency to reducing the gap between CBU and CKD. The narrow gap of tariffs between Completely Built Up and Completely Knocked Down had dual impact on the industry. One aspect was that the local Original Equipment Manufacturers were also forced to achieve maximum indigenization level. The other aspect was that the local industry would be exposed to free market competition.

2.3.2 A Comparative analysis of Duty Structure with Regional Countries

At this point, it would be of value to compare the duty structure prevailing in the domestic industry with the Indian auto sector. The following picture summarizes the duty structure for CBU and CKD from 2004 to 2005.

Figure 1 Comparison of Trade Barriers – Pakistan & India

*Custom Duties Excluding Sales Tax and other levies

	India	Pakistan
CKD Duties	20%	35%
New Car Duties	Seating Capacity 9 or less 100.2 %	Up to 1500 cc 50% 1500cc -1800 cc 65% 1800cc + 75%
Used Car Duties	*156.5% Depreciation allowed: 1 Yr 16% 2 yrs 12% 3 yrs 10% 4 yrs 8%	$4,000 -$21,000 Deprecation allowed: 2 % / month max. of 50% Up to three yr old cars allowed No requirements to register the vehicle in the name of a Pakistani national prior to its import

Source: Indus Motors, 2005

The above figure reveals that the automobile industry of India was also protected by tariff and non-tariff barriers. The non-tariff barriers were the establishment of testing agency, higher registration charges and submission of pre-shipment certificate. Therefore, the Indian industry, unlike Pakistan's auto sector, had greater reliance on non-tariff barriers. Further, the Indian Industry had higher custom duty rate on new cars.

Table 2: Comparative Analysis of Duties in Pakistan and India-2005

CKD DUTY	INDIA	PAKISTAN
Customs Duty	*20%	35 %
Sales Tax/VAT	*16%	15%
Total	36%	50%
PARTS- FOR MANUFACTURERS		
Customs Duty	20%	35%
Additional Customs	16%	-

Duty		
Sales Tax	-	15%
Income Tax	-	6%
Total	36%	46%
CBU		
Customs Duty	105%	20% - 75%
Additional Customs Duty	24%	
Sales Tax		15%
Income Tax		6%
Calamity contingent duty	1%	1%
Cess	0.125%	
Capital value tax		Up to 7.5%
Total	145.125%	
USED CARS		
Customs Duty & other duties	180%	2% per month depreciation
*As per Indian localization policy where car manufacturers were required to localize any one of the following 7 assemblies i.e. i) Engine Assembly ii) Body/Cab iii) Chassis iv) Gear Box v) Transmission System vi) Axle Front & Rear vii) Suspension.		

Source: Pakistan and Gulf Economist (*2005*).

The above table 2 depicts the Pakistani Automobile Industry had a higher tariff rates than Indian Industry on CKD and auto parts units. However, Indian Industry had greater tariff rates on CBU units and used cars.

2.3.3 New Tariff Based System (TBS)

On 1st July, 2006, the deletion program for the automotive sector was replaced by the Tariff Based System (TBS). Following orders were issued for this new system:

- SRO 655(I) / 2006 dated June 22, 2006 (For vendors)
- SRO 656 (I) / 2006 dated June 22, 2006 (For OEMs)
- SRO 693 (I) / 2006 dated July 1, 2006 (For OEMS)

According to SRO 655(1)/2006, the rates were set to 0% custom duty on raw material, 5% on sub-components, 10% on components and 15% on Sub-assemblers. The new tariff based system was introduced to achieve the following objectives (Ministry of Industries and Production, 2008):

- To facilitate job creation

- To Protect the existing & planned investment by the OEMs & Vendors
- To attract new investment
- To encourage value addition
- To introduce new technologies
- To widen the consumer base so as to create economies of large scale

The basic framework of tariff based system was as under:

- Only those assemblers would be allowed to Import units in CKD condition who had required assembly facilities and who were registered with the sales tax department.
- If the localized parts were imported in CKD form, the duty would be charged at a high rate.
- Those parts which were yet to be indigenized would be allowed at CKD rate of custom duty.

2.3.4 Effective Protection Rate

Effective Protection Rate is used to determine the degree of protection for an industry. The automobile industry was one of the most protected industries in the country. The industry comparatively enjoyed a very high effective protection rate. Following table reveals the effective protection rate for the industry in 1997:

TABLE-4: Effective Protection Rate to Auto Industry

Vehicle Type	IMPORT % CKD/ RM	TARIFF CBU	TARIFF CKD/ RM	EPR
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 and competing against smuggled items	30%	20%	65%	1%

Source: Centre for Management and Economic Research, (1997)

Besides the effective protection rate shown in the table 4, the effective protection rate (EPR) for the industry in 2001 increased quite substantially which ranged from 701 per cent to 5,000 per cent (Sharif and Ahmad, 2001).The rationale for that high protection rate was just to enable the industry to achieve targeted indigenization level in compliance with the policies of the World Trade Organization. Unfortunately, the industry could not meet the commitments and it indulged in short term benefits for maximization of profit. The high EPR made the local industry dull, uncompetitive and profit oriented. Regarding profitability, only one example is enough that Pak Suzuki Motor Company booked the profit of Rs.148.716 million in 2002 as against Rs.52.97 million in 2001. Therefore, the sector was rightly criticized for creating monopoly, offering few choices to consumers, selling vehicles on higher prices and booking very high rate of profits. Furthermore, the industry was also entering into the post WTO scenario especially with the provisions of Trade Related Investment Measures (TRIMS) and Trade Related Intellectual Property Rights (TRIPS). In those circumstances, the sector was not likely to sustain such a high rate of protection and the industry had to face a very tough time from the giants of world's auto manufacturers. Regardless of the threats from WTO, there was immense pressure from the dealers of used cars who persuaded the authorities to allow the import of old and reconditioned vehicles. The dealers had always been attempting in the past to influence the authorities to get a favorable decision. Once they succeeded in their efforts, the government would be forced to allow the import of used vehicles with certain relaxed conditions. Therefore, the industry was required to take serious measures so as to stand confidently on it own toes to cope with the challenges.

2.4 Indigenization Level

The rationale laid down by the policy makers for the high protection rate was just to enable the sector to achieve indigenization level in the parts, accessories and manufacturing of entire vehicle. In this way, the industry would be able to reduce import bill and save foreign exchange for the country by producing more and more local contents for vehicles.

TABLE-5: Indigenization Level in 1995

Vehicle	Indigenization Level
Suzuki Mehran 800cc	58%
Suzuki Khyber 1000cc	44%
Suzuki Margalla 1300cc	35%
Suzuki Pick up 800cc	52%
Suzuki Potohar 1000cc	35%
Suzuki Van 800cc	47%
Toyota Corolla	28%
Honda Civic	28%
Tractor Massey Ferguson	84%

Tractor Fiat	84%
KIA Ceres	26%
Honda Motorcycles	70%
Yamaha Motorcycles	70%
Suzuki Motorcycles	65%

Source: Pakistan and Gulf Economist (1996)

The performance of the industry pertaining to indigenization had never been satisfactory since 1949. During 1960s, the indigenization level was 40% for trucks & buses and 20 % for cars. In 1995, the deletion level for parts in different vehicles was mentioned in table-5.

In 1995, the government formed Engineering Development Board to formulate the long term policies for the industrial sector. The board established a committee which was known as indigenization committee. Its objective was to prepare and monitor the new type of deletion program called "Industry Specific Deletion Program" (ISDP). The committee set the targets for the industry to achieve indigenization level up to a certain time period as depicted by Table 6.

TABLE-6: ISDP for Automotive Sector

S. No.	PRODUCT	ISDP Targets				
		June 2001 %	June 2002 %	June 2003 %	June 2004 %	June 2005 %
1.	**CARS**					
	Cat. 1, Upto 800 cc	70.00	70.00	70.25	70.50	71.00
	Cat. 2, Above 800cc Upto 1200cc	55.00	58.00	61.00	64.00	66.00
	Cat. 3, Above 1200cc	50.00	53.00	56.00	59.00	62.00
2.	**TRACTORS**					
	Cat. 2, Above 40 & Upto 55HP (2x2)	82.50	83.00			
	Cat. 3, Above 55 & Upto 80 HP (2x2)	60.50	62.50			
	Cat. 4, Above 55 & Upto 80HP (4x4)	48.00	50.00	52.00		
3.	**MOTORCYCLES**					
	Cat. 1, Upto 70cc	83.00	85.00	86.50	88.00	90.00
	Cat. 2, Above 70 Upto 100cc	82.00	83.00	85.00	85.50	86.00
	Cat. 3, Above 100 Upto 175cc	74.00	81.00	82.00	83.00	84.00
4.	**COMMERCIAL VEHICLES**					
	Cat. 1, Pickup 2 Ton GVW	63.00	65.00	67.00		
	Cat. 2(A), Pickup S/C, 4x2, Above 1500cc Upto 2999cc GVW Above 2 Tons Upto 5T	38.00	43.00	48.00		
	Cat. 3, Rigid Truck 4x2, 5 to 8 Tons	49.00	49.50	50.00		
	Cat. 4, Rigid Truck 4x2, Above 8T	53.00	54.00	55.00		
	Cat. 5(A), Rigid Truck 6x2, Above 8 Tons Upto 30 Tons	50.00	51.00	51.50		
	Cat. 5©, Truck, Tractor/Prime mover 4x2, GCW, Upto 30 Tons	42.70	42.70	42.70		
5.	**BUSES**					
	Cat. 1, Mini Bus Upto 30 Passengers	44.70	45.80	47.00		
	Cat. 11, Above 75 Passengers	46.50	47.50	48.50		
6.	**SPORTS UTILITY VEHICLE (SUV)**					
	SUV, 4x4		40.00	43.00	45.00	48.00
7.	**ALL TERRAIN VEHICLE**					
	Jeep Type		40.00	44.00	48.00	52.00

* Indicative targets keeping in view that the tariff based system to be put in place at an appropriate time to ensure promotion of indigenization in line with our international commitments.

Source: Ministry of Industries and Production 2004 (a)

As against the targets set by the committee, the performance of the industry in 2002-03 was not satisfactory as shown in table 7. The industry was apparently far behind from achieving the desired targets in 2002-03 in most of the vehicles.

TABLE-7: Achievement of Maximum Local Content Levels (2002-03)

S.No.	Vehicle	Percentage
1	Cars	56-70
2	Tractors	63.5-85.5
3	Motor cycles	81-88
4	Light Commercial vehicles	42.7-55
5	Buses / Trucks	46.5-48.5

Source: Ministry of Industries and Production 2004

As far as the localization of parts was concerned, the status of the vendors for different companies was as under:

TABLE-8: Company Wise Vendor Information-2004

Name Of the Company	Total Vendors	Deletion Status	No. Of Parts Localized	Models
Indus Motor Co.	61	38% - 55.5%	1,100	(All models)
Pak Suzuki	180	70%	2,800	(All models)
Honda Atlas Cars	77	60.00 %	699	
Dewan Farooq Motor	107	37% - 58%	1,311	
Total	425		5,910	

Source: Ministry of Industries and Production 2004

The next year, the indigenization level for different vehicles was improved slightly as shown below:

TABLE-9: Level of Indigenization-2005

Type of Vehicle	Indigenization Level
Passenger Cars	Up to 72%

Light Commercial Vehicles	Up to 52%
Buses	Up to 52%
Tractors	Up to 85%
Trucks	Up to 52%
Motor Cycles	Up to 89%

Source: Indus Motors, 2005

3. CONCLUSION

Despite all the efforts made by the authorities during different periods, the vehicles assembled in Pakistan were less competitive in the global market. In spite of the release of Industry Specific Deletion Policy, the industry was heavily dependent on imported contents in form of completely knocked down (CKD) kits. The state of industry in the manufacturing of automobile parts was not up to the mark. For instance, the basic component for the production of automobile was engine, but the industry used to import the engines in Completely Built up (CBU) condition. Similarly, most of the body components were imported in completely knocked down (CKD) form. However, the indigenization level for motorcycles and tractors was very much in accordance with the expectations.

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