

Initial two years assessment and Succession of TBS

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Tariff Based System (TBS) for the automotive industry succeeded the compulsory local content conditions, commonly referred as “Deletion Programs” on 1st July 2006. Without going into details of any achievements of deletion programs, fact remains that its elimination was externally driven. Pakistan was the only country pursuing these programs despite a signatory of “Trade related investment measures (TRIMS)” agreement of the WTO. On the repeated demands of auto industry i.e. assemblers and vendors, Government requested the WTO to give extension until the year 2006. Earlier, WTO gave a deadline of December 2003 to eliminate all the deletion programs. The matter however, never came up before the relevant committee of WTO for a debate on the issue.

A feel good factor in Pakistan’s economy (2002-2007) accelerated the production and sales of vehicles, in particular the motor cars and motor bikes. A surge in growth also owed largely to the availability of financial options on car purchase, supported by low interest rates of that period. That was the time when large investments were made by the vendors as well as the assemblers. Deletion programs during that period appeared to have effectiveness as witnessed from improvement in local content, jobs, tax revenue, retail, financial and logistic activities, investment and interdependency of vendors and assemblers.

Government and industry had limited options as deadline was looming close, except to start thinking on a system which could possibly replace the deletion programs. Local industry, particularly the vendors under the umbrella of PAPAAM were apprehensive on the possible elimination of system. A large majority of vendors were small and medium enterprises and had established their businesses based on compulsory local buying of parts by assemblers and on the bandwagon of high growth rate. Motor cars and motor bike segments registered ACGR of 33% and 47% respectively during 2001-2006.

Anticipating no respite from WTO, Government locked horns with industry to negotiate for a successor system, during 2003/04. Reaching to a winning solution, both for vendors and assemblers was tough and indeed challenging for the Government. The vendors had strongest apprehensions that any future system merely relying on higher import tariffs for localized parts, but otherwise allowing restriction free import of such parts and components would hurt them badly on account of following factors.

- i. Local vending industry was no where near to the scales of production, comparing to Thailand, Indonesia and Japan – the common sources of CKD import.
- ii. Being low volume producers, price competitiveness was difficult to achieve until CBU production reaches to a critical mass of at least 300-400K per year.

- iii. Assemblers have a tendency to purchase components from their principals or their designated overseas companies and high tariffs could be mitigated through under valuation/misdeclaration, etc.
- iv. Further indigenization of components, sub-assemblies and assemblies would be stopped. Withdrawal of deletion programs may therefore not be sustainable for the industry.

Based on these common apprehensions, vendors came up strongly in the favour of a system which could possibly save their investments; stabilize production and sales volumes and which could rather induce future investments and indigenization. The following conditions were therefore proposed as minimum safeguard for the future;

- i. No roll back of the parts and components already indigenized.
- ii. Facilitate further indigenization and investment.

Above conditions were largely agreed by the Government and industry including the assemblers with certain apprehensions. The next challenge remained the identification and formulation of a workable mechanism which could cater to the above needs. After extensive deliberations, industry agreed to formulate lists i.e. "A Max" and "A Min" for the parts and components which were indigenized and non-indigenized respectively. That was agreed that Deletion monitoring year 2004 (DMY 2004) would be taken as a benchmark. This would provide details of local content level achieved, parts, components, sub-assemblies and assemblies deleted by each make and model of a vehicle.

To address different local content levels in different engine capacity cars of different assemblers, it was decided to base the categorization on Customs Tariff Codes and all cars within that category may be considered as one for the sake of local content. The motorbikes posed least problem due to limited models i.e. 70 cc, 100 cc and 125 cc. Moreover, motorbikes had the highest local content i.e. around 80%, the assemblers were local, hence no clash of foreign principals/shareholders interests, etc.

During this entire exercise, Government continued emphasizing upon the industry to limit the scope of TBS for 3-5 years only, as a transitional mechanism. The work on design and structure of TBS was therefore started during the year 2005, with a commitment to complete by February/March 2006, so as to further fine tune it and forward to the FBR for Governments approval and making a part of Finance Bill 2006/07.

Structure of TBS was agreed on the following lines by various committees constituted by the Engineering Development Board (EDB) and consultants duly appointed by the Government and Industry;

- i. List all the indigenized parts of a category of vehicle through creation of additional tariff lines in the Pakistan Customs Tariff.

- ii. Propose a duty structure to the government to levy additional customs duty on indigenized parts, keeping in view the respective CBU Duty rates as well. As such Additional Duty on localized parts of Cars, LCV's, motorbikes and auto rickshaws was proposed at 50%.
- iii. While the maximum Duty was proposed at 35% on the import of indigenized parts, etc. for the assembly of vehicles such as tractors, prime movers, buses and trucks.
- iv. To make the system workable, a notification was drafted which prescribed the compulsory submission of lists of importable parts as CKD Kit of indigenized and non- indigenized components, for the certification of EDB. Such lists would then be entered in the record of Customs for allowing clearance of imported CKD kits, accordingly.
- v. The system provided provisions for audits, maintenance of comprehensive records and annual reconciliations.

TBS while replacing deletion programs provided some freedom and liberty to import, even the indigenized components albeit against higher duty. The new system was not entirely a business friendly in its context, nature and impact. Like deletion programs, lot of man management is involved in the micro-issues such as lists of components, scrutiny, tariff coding, certification and assessment besides laborious record keeping and reconciliations, etc. Government and industry allocate resources, time, effort and talent to manage the system despite being open and transparent in nature.

On account of extensive documentation and plethora of details, annual assessment and audits should have been rather pursued to see the possible loop holes, pass through, under valuation and misdeclarations, etc. Importantly, the assessment on the issue of future indigenization during the initial two years should also have been made. That was important to make necessary corrections and to effectively steer the system which involved painstaking Government-industry deliberations.

While during TBS formulation, there was consensus that its life would remain 3-5 years and during that period, deliberations would be started to look for the new system. The five year tariff plan (2006/07 to 2011/12), becoming a part of AIDP remains a matter of great satisfaction but what comes after, needs to be predetermined much earlier for present and potential players of Auto industry.

It reminds us the South African Government's recent approval of "Automotive Production and Development Program (APDP)", to replace Motor Industry Development Program (MIDP). It is interesting to note that MIDP was implemented during 1995 for termination by the end of 2009, with policy commitment continuing until the year 2012. Realizing that the industry needs certainty over an extended period for its investment to take place, Government approved the APDP in advance for implementation from 2012 and continuing until 2020.

While AIDP has provided a certain degree of predictability and transparency, regarding import tariffs, the Government and industry may initiate deliberations on a system succeeding the TBS.

But before that a comprehensive assessment of present system, since its implementation from 1st July, 2006 is highly important. This will not only divulge the operational side of it, import trends but indigenization issues as well.

The assessment may also reveal certain strengths or weaker policy areas which could indeed facilitate in improving or replicating the policy in some other segments of industry. The real challenge does not lie in formulation of right policies but in their effective and efficient implementation and execution. A regular assessment of the present system is therefore undoubtedly hugely significant, paving the way for early negotiations on a system to succeed the TBS.