

CBR Quarterly Review

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**A Review of Resource Mobilization Efforts of
Central Board of Revenue**



CENTRAL BOARD OF REVENUE

Government of Pakistan

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Foreword

The CBR Reform program is well on its way and a number of initiatives have been undertaken in the recent past to facilitate taxpayers to honor their tax obligations with respect. One such initiative is the 'Income Tax Assistant' – a software prepared painstakingly and circulated by CBR prior to the September deadline of submitting income tax returns. A brief note on it has been included in this issue.

The instant CBR Quarterly Review is presented with the objective of sharing with stakeholders the efforts of CBR to improve tax collection and administration. This journey was started in June 2002 when the first issue of the Review was published. The quarterly analysis of data is carried out as soon as the disaggregated information becomes available and it is circulated far and wide among representatives of trade and investment bodies, policy planners, researchers, and tax practitioners. We have received valuable comments and, occasionally felicitations, from our valued readers.

One of the major shifts in our analysis is the preference for thematic presentations. The articles in the Review now revolve around topics of policy interest. The current issue focuses on Pakistan's compliance with various WTO Agreements with special emphasis on market access and customs valuation. Let me hasten to add that some of the views expressed in the Review deviate somewhat from the official viewpoint. Nonetheless, it only emphasizes the new CBR culture of encouraging freedom of expression.

While complimenting the efforts of the Fiscal Research wing at CBR, I look forward to receiving continued feedback from our esteemed customers.

*Riaz A. Malik
Chairman, CBR*

I

CBR Tax Collection: An Analysis of Revenue Statistics of Q1:03-04¹

The Economy

Pakistan's economy has maintained its upswing for the fifth quarter running. This means that, technically, the economy has come out of an extended period of recession. The strength of economic fundamentals, rising domestic and external demand, and stability of the financial markets corroborate that the economy has reached the stage of sustained growth. The recent decision of the government to retire expensive debt earlier than the due date also confirms that prudent economic management has provided the much-needed fiscal space to focus on social sectors that were reluctantly overlooked in the past to settle the heavy debt burden. At the same time there is no denying that external factors that influenced rescheduling of debt and raised the level of capital inflow through formal banking channels have also helped in achieving the immediate objective of economic revival and financial stability. Nonetheless, we believe that the implementation of wide-ranging reform programs and consistency of policies have a bigger share in reversing the fortune to regain the lost credibility and to meet international commitments.

A brief review of the 1st quarter statistics confirms that there is ample evidence of broad-based recovery. However, the future outlook remains watchful in certain areas. Most importantly, in the agriculture sector the initial damage to the cotton crop caused by rains has been deteriorated further due to pest attack. Despite the optimism shown by MINFAL that the production target would be achieved due to 15% increase in the sown area, the market situation

¹ The Research Team of the Fiscal Research Wing of CBR has prepared this Chapter. Valuable support by the staff of the Budget Wings of Direct & Indirect Taxes and the Directorate of Research & Statistics is gratefully acknowledged.

stays precarious. Similarly, wheat production can be affected adversely, especially in the sugarcane growing areas, if the crushing season is delayed further. Needless to add that better availability of sufficient irrigation water during *Kharif* and *Rabi* seasons, and expected gains through bumper rice crop have brightened the overall prospects, which means that the contribution of the agriculture sector in GDP may not differ significantly from its initial estimates.

It is also refreshing that the production of leading industries has started to pick up. For thirty-nine manufactured items, that constitute 42% of the manufacturing sector output, the growth in production has been 6.8% during July-August 2003. Some of the products registering robust growth were: motor vehicles including motorcycles 53.6%, cotton cloth 21.3%, jute goods 21.6%, caustic soda 17.3%, cement 15.5%, cigarettes 15.3%, and coke 12.3%. However, why the contagion effect is missing and widespread recovery of the industrial sector is delayed remains a concern? The lukewarm response of private sector could have been due to various reasons including higher cost of doing business, inadequate level of skills of the available work force, poor maintenance of the existing infrastructure, and most importantly, the missing enthusiasm and coordination among relevant public institutions to create conducive environment for investment in the country.

The external trade sector despite being vibrant remains narrowly concentrated in few commodity groups. According to the CBR data, total imports have increased from Rs. 172.5 billion in Q1:02-03 to Rs. 179.3 billion in Q1:03-04, indicating a growth of around 4%. However, imports of 15 major commodity groups, constituting 82% of the total import value, have increased by 18.5%. Similarly, even though the rupee value of exports has increased by 11.3% during the 1st quarter of FY 03-04, the driving force behind this growth continues to be the textile sector. Nevertheless, irrespective of the commodity composition of foreign trade, the growth pattern of

imports and exports has resulted into further improvement in the current account position.

Another brighter side of the economy is the reinforcement of the real sector gains by the stability of the financial sector that has been ensured through careful manipulation of the monetary/ exchange rate policy mix and a strict monitoring of financial institutions. Excess liquidity has been moped up through effective open market operations and in the process the collusive arrangement among banks to raise interest rate has been discouraged. The most notable development is the receding fear of deflation.

To sum up, the improved macroeconomic environment substantiates that the broad ranging policy reform agenda that envisioned a competitive milieu and level playing field for all stakeholders has been realized to a great extent. However, the economy has not yet reached the level of maturity. Low savings and investment rates, persisting unemployment, and high incidence of poverty remain some of the significant missing links to overall development that require continued attention.

CBR Revenue Target for FY 03-04

The following regression equation has been used to describe the tax revenue and GDP relationship in a simplified way:

$$\text{Log (Tax Revenue)} = -1.83 + 0.976 \text{ Log (GDP at market prices)}$$

(-12.80) (95.45)

$$R^2 = 0.998 \quad \text{D.W.} = 1.66 \quad F = 9111.5$$

Based on the buoyancy estimate of 0.976 and the projected value of nominal GDP at market prices, the baseline revenue target for FY

03-04 is estimated to be Rs. 494.2 billion.² This includes a net reduction of Rs. 10 billion in revenue on account of various tax measures introduced during current and past fiscal years, which are briefly discussed in the following paragraph. The CBR revenue target for FY 03-04 is, nonetheless, fixed at Rs. 510 billion so that tax/GDP ratio could be maintained at 11.5%. The target envisages an increase of 10.7% over actual collection of Rs. 460.6 billion in FY 02-03. A comparison of the budgetary targets of major taxes with actual collection presented in Table 1 indicates that an increase of 6.2% is anticipated for direct taxes, 14.5% for sales tax, 13% for customs duties and 6% for central excise duties.

Table 1: Comparison of Collection and Target: FY 03-04 over FY 02-03

| | Collection FY 02-03 | Target FY 03-04 | Difference (Percent) |
|------------------|------------------------|--------------------|-------------------------|
| Direct Taxes | 151.7 | 161.1 | 6.2 |
| Sales Tax | 194.8 | 223.1 | 14.5 |
| Customs | 69.1 | 78.1 | 13.0 |
| Central Excise | 45.0 | 47.7 | 6.0 |
| All Taxes | 460.6 | 510.0 | 10.7 |

Some of the specific fiscal initiatives introduced at the time of Budget 2002-03 and Budget 2003-04 are as follows:

- a) *The Revenue Impact of Measures Taken in Budget 2002-03:*
The direct tax collection will have an adverse impact of Rs. 3.6 billion on account of three tax measures announced in the Federal Budget of 2002-03. First, the minimum threshold of exemption from income tax for individuals (and association of persons) was raised from Rs. 60,000 to Rs. 80,000 to provide relief to low and low-to-medium income earners. It is anticipated that this measure will reduce income tax

² The nominal GDP at market prices is projected to grow by 9.5% during FY 03-04. This requires that non-agriculture (nominal) income and large-scale manufacturing (nominal) income grow by 10.1% and 9.5% respectively. Additionally, imports and dutiable imports (at current prices) are expected to increase by 12.1% during FY 03-04 as dollar-rupee parity is expected to remain stabilized.

collection by about Rs. 2.4 billion. Second, the reduction in tax rates of banking and private companies to create parity will cost around Rs. 1 billion to national exchequer, and third, the increase in the mark-up limit for housing loans will reduce direct tax collection by about Rs. 220 million.

- b) *Tariff Rationalization to Support Industrial Growth:* On the basis of a detailed rationalization exercise, duty on 259 items classified as raw materials and components for industrial sectors such as heavy engineering, capacitors, auto-engineering and agriculture implements, casting and forging, items for ceramics industry, fan industry, surgical and cutlery, bulbs and tube lights etc has been reduced. However, with a view to give protection to the local industry, the duty on old and used dumpers has been raised from 40% to 100%. Similarly, for locally manufactured parts of electricity meters from it has been raised from 10% to 20% and 25%, on old and used computer monitors from zero to 25% and on waste paper other than pressed bundles from 10% to 20%.
- c) *Reduction of Customs Duty on Smuggling prone items:* The rate of duty on smuggling prone items like tea has been slashed from 25% to 20%, spices (nutmeg, mace and seeds of anise or badian) from 20% to 10%, silk yarn from 15% to 10% and ball bearings and wristwatches from 10% to 5%.
- d) *Exemption of Customs Duty on Oilseeds and levy of Sales Tax instead:* Prior to the announcement of the Budget for CFY, oil-seeds used for the extraction of edible oils were exempt from sales tax but chargeable to customs duty @ 10%. In order to broaden the sales tax net, Customs duty has been withdrawn and replaced with levy of sales tax on import of edible oil seeds.
- e) *Reduction of CED on Cement:* Cement has remained a heavily taxed item over the years. CED on this item was reduced from Rs.1400 per MT to Rs.1000 per MT in

September 2000. Additionally, it was also liable to sales tax at the standard rate of 15%. In order to give relief to construction activity, CED has been reduced from Rs.1000 to Rs.750 per ton. Even though this measure will reduce CED collection by about Rs. 2.7 billion, nonetheless, it is anticipated that the Cement Industry will flourish as a consequence and consumers will also get relief in the shape of lower retail price of cement.

- f) *Withdrawal of CED on Wires & Cables and Paper & Paperboard:* In continuation with government policy to reduce items subjected to CED and instead rely on GST, paper and paperboard and wires and cables have been exempted from CED. While these exemptions will generate far-reaching benefits towards strengthening of the related up- and downstream industries, they will reduce CED collection by about Rs. 1.5 billion.

Monitoring CBR Revenue Collection

In an effort to monitor revenue collection on regular intervals, monthly and quarterly targets of the four taxes have been prepared on the basis of historical trends in collection, i.e., average collection during FY 97-98 and FY 02-03. Slight adjustments have been made to these guiding posts in the light of the most recent outturn and the policy initiatives undertaken during the year. Accordingly, the revenue target for the July-September 2003 has been fixed at Rs. 92.2 billion, which constitutes about 18.1% of the yearly target. Similarly, to maintain consistency, greater reliance is placed on GST and direct taxes. Nearly 46% of the 1st quarter net collection is expected to come from sales tax and 27.4% from direct taxes (*Table 2*). The revenue targets for the 2nd, 3rd, and 4th quarters are fixed at Rs. 125.9 billion, Rs. 123.9 billion, and Rs. 168.1 billion, which constitute about 25%, 24%, and 33% of yearly target, respectively. The end loading should not be surprising as it is not an exception.

Table 2: Monthly and Quarterly CBR Targets for FY 03-04*(Rs. Billion)*

| | Direct Taxes | Sales Taxes | Customs Duties | Central Excise | All Taxes |
|-------------------|--------------|--------------|----------------|----------------|--------------|
| July | 6.2 | 10.3 | 4.9 | 2.0 | 23.4 |
| August | 7.6 | 14.5 | 5.0 | 3.0 | 30.1 |
| September | 11.5 | 17.5 | 6.2 | 3.5 | 38.7 |
| Quarter: 1 | 25.3 | 42.3 | 16.1 | 8.5 | 92.2 |
| October | 12.3 | 17.1 | 5.8 | 3.6 | 38.8 |
| November | 11.4 | 17.3 | 5.2 | 3.6 | 37.5 |
| December | 21.3 | 17.7 | 6.9 | 3.7 | 49.6 |
| Quarter: 2 | 45.0 | 52.1 | 17.9 | 10.9 | 125.9 |
| January | 12.2 | 18.1 | 6.8 | 3.7 | 40.8 |
| February | 10.6 | 18.3 | 6.5 | 3.8 | 39.2 |
| March | 13.7 | 18.5 | 7.5 | 4.2 | 43.9 |
| Quarter: 3 | 36.5 | 54.9 | 20.8 | 11.7 | 123.9 |
| April | 14.3 | 20.0 | 7.8 | 4.7 | 46.8 |
| May | 14.1 | 24.9 | 7.5 | 5.4 | 51.9 |
| June | 25.9 | 29.1 | 8.0 | 6.4 | 69.4 |
| Quarter: 4 | 54.3 | 74.0 | 23.3 | 16.5 | 168.1 |
| Full Year | 161.1 | 223.1 | 78.1 | 47.7 | 510.0 |

CBR Revenue Position

The revenue target for the 1st quarter of FY 03-04 has been achieved. CBR has managed to collect Rs. 94.1 billion against the target of Rs. 92.2 billion, which is 2.1% higher than the target. The momentum in revenue collection has been maintained largely due to broad-based growth of the economy. At the same time various policy initiatives undertaken by CBR over the last few years have started to payoff. A favorable tax friendly environment has been created and maintained that has encouraged taxpayers to support tax policy and administrative reform initiatives of the government. They are now part of the new taxation system.

Overall Collection and Refunds

Traditionally, even though the collection is somewhat slower at the start of new fiscal year, this year the tradition has been set aside. It is the fifth consecutive quarter running that the collection has been

according to the projections made at the beginning of the year. A comparison of individual taxes with the first quarter targets exhibits an encouraging picture as the collection of three out of four federal taxes has exceeded their respective targets. The largest increase of 11.1% has been observed in the case of customs duties. Interestingly, the collection of central excise duties has also surpassed the target by 5.9% even though its collection has fallen short of last year's collection due to its fading nature. The only exception where the target has not been met is sales tax; its collection has missed the target by 1.7%.

Table 3 shows that, in absolute terms, the gross and net collection for Q1:03-04 has been Rs. 112.971 billion and Rs. 94.062 billion, respectively with the refund payments of Rs. 18.909 billion. Whereas the gross collection registered a modest increase of 0.4% in Q1:03-04, the net collection increased by 4.1% over the corresponding period of PFY. This increase should be regarded as a significant achievement, as it is over and above 16% growth observed during Q1 of PFY, which incidentally was a good quarter in terms of economic growth and revival of the economy after a rather longish period of down turn. The monthly data show that positive growth of about 2% was achieved in August but a significant growth of 9% was possible in September that effectively compensated for the dip of 1.2% in July.

**Table 3: A Comparison of Net Collection:
Q1: 03-04 over Q1: 02-03 (Rs. Million)**

| Revenue Heads | Q1: 03-04 | Q1: 02-03 | Growth (%) |
|--------------------------|---------------|---------------|------------|
| Direct Taxes | 25,578 | 23,593 | 8.4 |
| Indirect Taxes | 68,484 | 66,757 | 2.6 |
| Sales Tax | 41,597 | 43,781 | -5.0 |
| <i>On Imports</i> | 27,260 | 25,593 | 6.5 |
| <i>On Domestic Sales</i> | 14,337 | 18,188 | -21.2 |
| Central Excise Duties | 8,999 | 9,617 | -6.4 |
| Customs Duties | 17,888 | 13,359 | 33.9 |
| All Taxes | 94,062 | 90,350 | 4.1 |

Detailed Analysis of Individual Taxes

The detailed analysis of individual taxes is carried out to understand inter linkages between tax receipts and macroeconomic aggregates. It is believed that CBR performance is closely linked with the overall improvement in the economy. Since a number of fiscal policy initiatives have been undertaken during the current and past fiscal years with respect to broadening of tax bases and improvement in tax administration, it is relevant to know the impact of these policy changes on tax collection.

Direct Taxes: The gross collection on account of direct taxes during the 1st quarter of CFY was Rs. 27.4 billion, refunds Rs. 1.8 billion, and net collection Rs. 25.6 billion. This compares with gross collection of Rs. 27.3 billion, refunds Rs. 3.7 billion, and net collection Rs. 23.6 billion during Q1:02-03. Thus, the gross and net collection has increased by 0.3% and 8.4%, respectively, which is more than the required yearly growth of 6.2%. The important feature of this growth in direct tax receipts is the increase in collection with returns. Although the number of income tax returns filed by the taxpayers has declined by about 19% as of 10th October 2003 as compared to PFY, the amount of income tax submitted with returns has increased by 92%. This is a significant development and could be attributed to improved profitability of leading non-resident companies due to better turnover. This is also evident from an improved collection registered at the Large Taxpayer Unit, Karachi. As far as the reduction in returns is concerned, it could have been due to the increase in the minimum threshold from Rs. 60,000 to Rs. 80,000 during the Budget 02-03. Both these factors require further investigation, that will remain pending until the availability of computerized data on returns.

Components of Income and Corporate Taxes: While the first two major components of income tax, i.e., voluntary compliance and collection on demand registered a negative growth during the 1st

quarter of CFY as compared to Q1 of PFY, the third component, i.e., the withholding taxes registered an increase to compensate for the fall in the other two components. As indicated earlier, voluntary compliance as a result of the introduction of Income Tax Ordinance, 2001 and the in-built concept of Universal Self-Assessment is significant. This is indicated by 92% increase in the income tax revenue along with the returns. However, this development has been overshadowed by a substantial reduction in advance payments (by 67.4%). Consequently, the voluntary compliance has registered a negative growth of 29.4% (Table 4). It may be added that advance payments are one of the leading sources of refund claims, which means that a fall in advance payments is expected to result in lower refund claims in the future.

Similar to voluntary compliance, the collection on demand, arrears as well as current, has registered a decline of 20.4% and its share in gross income tax receipts has also fallen to 4.4% against 5.3% during Q1 of PFY. Although this is not an unusual phenomenon, at least during the 1st quarter, this decline could be due the gradual shift in perception of tax collectors and taxpayers about the new tax regime where the emphasis is being shifted from full assessment to risk-based audit.

**Table 4: Monthly Data on Voluntary Payments & Collection on Demand:
A Comparison FY 03-04 & FY 02-03 Collection**

(Rs. Million)

| | FY: 03-04 | FY: 02-03 | Difference | |
|-----------------------------|-----------|-----------|------------|---------|
| | | | Absolute | Percent |
| <i>Voluntary Payments</i> | | | | |
| July | 165.1 | 230.2 | -65.6 | -28.4 |
| August | 76.7 | 441.2 | -364.5 | -82.6 |
| September | 4959.5 | 6697.9 | -1738.4 | -26.0 |
| Quarter 1 | 5201.3 | 7369.3 | -2168.0 | -29.4 |
| <i>Collection on Demand</i> | | | | |
| July | 364.3 | 196.8 | 167.5 | 85.1 |
| August | 459.9 | 310.4 | 149.5 | 48.2 |
| September | 307.1 | 914.2 | -607.1 | -66.4 |
| Quarter 1 | 1131.3 | 1421.4 | -290.1 | -20.4 |

Finally, the direct tax collection on account of withholding taxes (WHT) has increased by 6.5% during the 1st quarter of CFY (Table 5). Simultaneously, the contributing of WHT in gross income tax

**Table 5: Monthly Data on WHT: A Comparison of
FY 03-04 & FY 02-03 Collection**

(Rs. Million)

| Collection Heads | FY: 03-04 | FY: 02-03 | Difference | |
|-------------------------------|----------------|----------------|---------------|------------|
| | | | Absolute | Percent |
| <i>Contracts</i> | | | | |
| July | 1270.7 | 1079.3 | 191.4 | 17.7 |
| August | 1438.5 | 1585.5 | -147.0 | -9.3 |
| September | 1878.3 | 1597.7 | 280.6 | 17.6 |
| Q1 | 4587.5 | 4262.5 | 325.0 | 7.6 |
| <i>Securities</i> | | | | |
| July | 433.9 | 197.5 | 236.4 | 119.7 |
| August | 656.3 | 500.1 | 156.2 | 31.2 |
| September | 213.6 | 275.7 | -62.1 | -22.5 |
| Q1 | 1303.8 | 973.3 | 330.5 | 34.0 |
| <i>Imports</i> | | | | |
| July | 2078.7 | 1823.6 | 255.1 | 14.0 |
| August | 1862.7 | 1742.6 | 120.2 | 6.9 |
| September | 1866.8 | 1742.6 | 124.2 | 7.1 |
| Q1 | 5808.2 | 5308.7 | 499.5 | 9.4 |
| <i>Salary</i> | | | | |
| July | 418.1 | 552.0 | -133.9 | -24.3 |
| August | 778.7 | 616.0 | 162.7 | 26.4 |
| September | 808.0 | 789.8 | 18.2 | 2.3 |
| Q1 | 2004.8 | 1957.8 | 47.0 | 2.4 |
| <i>Interest</i> | | | | |
| July | 274.9 | 347.2 | -72.3 | -20.8 |
| August | 427.2 | 636.9 | -209.7 | -32.9 |
| September | 336.2 | 462.5 | -126.3 | -27.3 |
| Q1 | 1038.3 | 1446.6 | -408.3 | -28.2 |
| <i>Sub-Total (Five Items)</i> | | | | |
| | 14742.6 | 13948.9 | 793.7 | 5.7 |
| Share in total WHT (%) | 76.7 | 77.2 | | |
| Other WHT | 4486.1 | 4111.7 | 374.4 | 9.1 |
| Total WHT | 19228.7 | 18060.6 | 1168.1 | 6.5 |

collection has jumped to 75% as against 67% during the corresponding period of last year. During the months of July and August, the growth in WHT was 11.8% and 80.6%, respectively, that declined in September 2003 by 26%. While the share of five-major withholding taxes, including contracts, securities, imports, salary and interest has declined from 77.2% to 76.7%, the contribution of imports (30.2%) remains at the top of the list,

followed by contracts (23.9%) and salary (10.4%). While the increase in WHT on imports by 9.4% has been driven by the increase in total imports by 4%, the 9% growth in WHT on exports is due to 11% increase in the volume of exports. The collection from securities has increased by 34%; mainly due to rate stabilization and better monitoring and 7.6% increase in contracts is because of the overall improvement in economic conditions.

Sales Tax: The gross and net sales tax collection has declined by 3.6% and 5%, respectively during the 1st quarter of CFY. In terms of value, the gross and net collection stood at Rs. 54.6 billion and Rs. 41.6 billion, respectively and refunds amount to Rs. 13 billion. While the import related net sales tax receipts increased from Rs. 25.6 billion during Q1:02-03 to Rs. 27.3 billion in Q1:03-04, showing an increase of 6.5%, the net domestic collection fell from Rs. 18.2 billion to Rs. 14.3 billion, presenting a negative growth of 21.2%. Let it be added that this decline may not be viewed as slow down in domestic demand rather a major portion of this reduction has been due to readjustment of advance payment of sales tax.

Domestic Sales Tax Collection: Around 62% of the collection of sales tax (domestic) has been realized from ten major revenue spinners during the first quarter of CFY (Table 6). A comparison of the current quarter data with the first quarter figures of PFY indicate that of ten major revenue spinners, POL products, natural gas, cigarettes and cotton yarn have contributed positively to GST collection. On the other hand, a major shortfall has been registered in GST revenue from services (telephone/ fax etc) and electrical energy mainly due to readjustment of advance payments. While the collection on services was higher in July by 32.2%, it fell drastically in the subsequent two months. Similarly, the collection on account of electricity consumption was abysmally low in July and August, but it increased by more than 100% in September to register an overall decline of 50% for the 1st quarter. The decline in sugar has

Table 6: Gross Collection of GST (Domestic) from Major Revenue Spinners*(Rs. Million)*

| | FY:03-04 | FY:02-03 | (%) | | FY:03-04 | FY:02-03 | (%) |
|--|----------|----------|-------|------------------------|----------|----------|-------|
| <i>POL Products</i> | | | | <i>Sugar</i> | | | |
| July | 948.9 | 1,531.7 | -38.0 | July | 544.3 | 618.7 | -12.0 |
| August | 2,000.6 | 1,274.0 | 57.0 | August | 557.9 | 627.1 | -11.0 |
| September | 1,891.5 | 1,472.3 | 28.5 | September | 596.0 | 643.4 | -7.4 |
| Q1 | 4,841.0 | 4,278.0 | 13.2 | Q1 | 1,698.2 | 1,889.2 | -10.1 |
| <i>Services (Including telephone/ fax)</i> | | | | <i>Cigarettes</i> | | | |
| July | 602.7 | 456.0 | 32.2 | July | 282.6 | 474.3 | -40.4 |
| August | 672.2 | 1,063.5 | -36.8 | August | 335.7 | 149.2 | 125.0 |
| September | 935.1 | 3,374.7 | -72.3 | September | 459.7 | 344.7 | 33.4 |
| Q1 | 2,210.0 | 4,894.2 | -54.8 | Q1 | 1,078.0 | 968.2 | 11.3 |
| <i>Electrical Energy</i> | | | | <i>Cement</i> | | | |
| July | 15.2 | 740.9 | -97.9 | July | 329.3 | 353.4 | -6.8 |
| August | 35.6 | 1,314.7 | -97.3 | August | 325.2 | 379.7 | -14.4 |
| September | 1,291.1 | 635.4 | 103.2 | September | 313.1 | 283.0 | 10.6 |
| Q1 | 1,341.9 | 2,691.0 | -50.1 | Q1 | 967.6 | 1,016.1 | -4.8 |
| <i>Cotton not carded or combed</i> | | | | <i>Cotton Yarn</i> | | | |
| July | 195.3 | 256.5 | -23.9 | July | 317.2 | 283.7 | 11.8 |
| August | 170.6 | 227.1 | -24.9 | August | 381.7 | 403.1 | -5.3 |
| September | 259.4 | 265.6 | -2.3 | September | 343.2 | 333.7 | 2.8 |
| Q1 | 625.3 | 749.2 | -16.5 | Q1 | 1,042.1 | 1,020.5 | 2.1 |
| <i>Natural Gas</i> | | | | <i>Fertilizers</i> | | | |
| July | 535.5 | 696.6 | -23.1 | July | 295.5 | 432.4 | -31.7 |
| August | 845.9 | 746.1 | 13.4 | August | 405.1 | 316.8 | 27.9 |
| September | 881.2 | 685.3 | 28.6 | September | 242.2 | 263.8 | -8.2 |
| Q1 | 2,262.6 | 2,128.0 | 6.3 | Q1 | 942.8 | 1,013.0 | -6.9 |
| <i>Total Major 10 Commodities</i> | | | | <i>All Commodities</i> | | | |
| July | 4,066.5 | 5,844.2 | -30.4 | July | 7,318.7 | 9,601.3 | -23.8 |
| August | 5,730.5 | 6,501.3 | -11.9 | August | 9,068.1 | 9,748.6 | -7.0 |
| September | 7,212.5 | 8,301.9 | -13.1 | September | 10,908.6 | 11,733.6 | -7.0 |
| Q1 | 17,009.5 | 20,647.4 | -17.6 | Q1 | 27,295.4 | 31,083.5 | -12.2 |

been the result of huge stock pile-up by mill owners with the expectation that government will allow its export, which did not materialize. Now that the new crushing season is approaching, it is anticipated that stocks will be released and consequently the sales tax revenue from sugar will stabilize. The collection from cotton has

suffered because of the weather condition that resulted into late sowing that also delayed its harvesting. Now that the crop is facing the danger of pest attack, it may also affect sales tax collection. However, going by the assessment of MINFAL that anticipates no major shortfall in production, an improvement in collection could be anticipated in coming months. Regarding cement, despite an increase in production by 15.5%, the sales tax collection witnessed a decline in July and August only to improve in September. The export of cement, which incidentally is zero-rated, and regulated domestic supply by cement cartel are the possible reasons for this erratic behavior. Finally, the decline in fertilizer production during July-August 2003 has been instrumental in the reduction of sales tax from this source.

Risk-Based Audit in Sales Tax: The role of audit is extremely important in order to keep the system transparent. For CBR it is even more important as it serves as an effective tool to curb tax evasion. The first quarter data of sales tax audit presented in Table 7 reveals that the number of audits conducted and amount detected has considerably declined during the CFY over the corresponding period of PFY. However, the overall recovery of the detected amount has improved considerably.

The historical data indicate that 16001 cases of audit were initiated during FY 2002-03. Since a vast majority of the audit reports showed NIL detection, it raised pertinent concerns about validity of the number of audits completed. Similarly, since CBR has adopted a new Audit Report Review procedure whereby each and every report must be sent to CBR for final review and only 4600 reports were received during the PFY, it is assumed that only 29% of the reported audits were actually conducted. Viewed within this perspective, the performance of audit during the 1st quarter of CFY is not that gloomy after all. However, further streamlining of data is required to draw meaningful conclusions.

Table 7: Sales Tax Audits: A Comparison*(Rs. Million)*

| | FY:03-04 | FY:02-03 | Growth (%) |
|-------------------------|----------|----------|------------|
| July | | | |
| No. of Audits conducted | 655 | 1615 | -59.4 |
| Amount Detected | 545.9 | 393.9 | 38.5 |
| Amount recovered | 43.6 | 33.7 | 29.4 |
| % Recovery | 8.0 | 8.6 | |
| August | | | |
| No. of Audits conducted | 602 | 1984 | -69.7 |
| Amount Detected | 636.7 | 579.2 | 9.9 |
| Amount recovered | 47.8 | 38.5 | 24.2 |
| % Recovery | 7.5 | 6.6 | |
| September | | | |
| No. of Audits conducted | 503 | 1713 | 70.6 |
| Amount Detected | 463.6 | 2381.1 | -80.5 |
| Amount recovered | 91.1 | 46.4 | 96.3 |
| % Recovery | 19.7 | 1.9 | |
| Jul-September | | | |
| No. of Audits conducted | 1760 | 5312 | -66.9 |
| Amount Detected | 1646.2 | 3354.2 | -50.9 |
| Amount recovered | 182.5 | 118.6 | 53.9 |
| % Recovery | 11.1 | 3.5 | |

Customs Duties: The revenue collection on account of customs duties is mainly driven by fluctuations in its base, which is rupee value of dutiable imports. The upsurge in imports observed during the PFY has continued during the 1st quarter of CFY – a reflection of a continuous improvement in domestic demand. Over 15% growth in dutiable imports has been fully translated in the revenue receipts of (gross) customs duties that also increased by about 16% during the first quarter. In terms of value, the gross revenue collection during Q1 03-04 has been Rs. 22 billion as opposed to Rs. 19 billion in Q1 02-03. Similarly, the net collection increased to Rs. 18 billion from Rs. 13.3 billion. The difference between gross and net receipts is refund/ rebate payments that declined by 27.1% largely due to the revision of the duty drawback rates.³

³ Since at the announcement of the Budget 03-04 customs duty was revised on a number of items, some of which were smuggling prone in nature, the impact of this policy change on customs duty collection was determined by separating the tariff lines influenced by this change. It is interesting to find that the impact of duty revision was felt only on 5% of total imports or 7% of dutiable imports. However, nearly 11% of CD revenue was affected by this change. Source Customs House data only.

The month-to-month growth in collection, presented in Table 8 shows that the largest increase in CD collection has been observed in September as compared to July and August. This phenomenon is consistent with restricted trade flows during the first two months of the new fiscal year due to budget announcement. The much higher growth in net CD receipts as compared to gross collection is due to negative growth in refund/ rebate payments that fell by over 25% consistently during July-September period.

Table 8: Comparison of Gross and Net collection of Customs Duties and Refund/ Rebate Payments
(Rs. Million)

| | FY:03-04 | FY:02-03 | Difference | |
|-------------------------|----------|----------|------------|---------|
| | | | Absolute | Percent |
| <i>Gross Collection</i> | | | | |
| July | 6432.0 | 5939.0 | 493.0 | 8.3 |
| August | 6858.0 | 6563.0 | 295.0 | 4.5 |
| September | 8676.0 | 6453.0 | 2223.0 | 34.4 |
| Q1 | 21966.0 | 18955.0 | 3011.0 | 15.9 |
| <i>Refunds</i> | | | | |
| July | 1499.0 | 2030.0 | -531.0 | -26.2 |
| August | 1484.0 | 2008.0 | -524.0 | -26.1 |
| September | 1095.0 | 1558.0 | -463.0 | -29.7 |
| Q1 | 4078.0 | 5596.0 | -1518.0 | -27.1 |
| <i>Net Collection</i> | | | | |
| July | 4933.0 | 3909.0 | 1024.0 | 26.2 |
| August | 5374.0 | 4555.0 | 819.0 | 18.0 |
| September | 7581.0 | 4895.0 | 2686.0 | 54.9 |
| Q1 | 17888.0 | 13359.0 | 4529.0 | 33.9 |

The chapter-wise collection of major revenue spinners is presented in Table 9 to draw further insight. Chapter 15 that relates to animal and vegetable fats (essentially edible oil) has been the largest source of CD collection during the first quarter of CFY. One of the reasons for this contribution is that during Q1 of CFY one hundred percent imports under this chapter were dutiable as compared to Q1 of PFY when 90.2% imports were dutiable. This also means that higher revenue has been generated despite the fact that the effective rate on dutiable imports has declined from 35.1% in Q1: 02-03 to 32.4% in

Q1: 03-04.⁴ The second highest source of CD collection was vehicles (Chapter 87) where 92% of total imports were dutiable. In this case the growth in dutiable imports was 33% and the growth in CD revenue was 47%. A similar pattern of growth has been observed for other commodity groups as well, particularly for machinery (Chapter 84), Chemicals (Chapter 29) and Iron & Steel (Chapter 72). Some of the commodities that registered negative growth in collection as compared to Q1:02-03 but still contributing significantly towards overall revenue were: Coffee and tea (Chapter 9), POL products (Chapter 27) and dyes and paints (Chapter 32). While in the case of coffee and tea the effective rate on dutiable imports has fallen from 23.5% to 18.9% during Q1: 02-03 and Q1: 03-04, it remained stable for the other two commodity groups.

Table 9: Chapter-Wise Growth of Major Revenue Spinners and Effective Rates

| PCT Ch. | Tariff Description | July-September Growth (%) | | | Effective Rates with Dutiable Imports | |
|------------|--------------------------|---------------------------|---------------------|-------------------|--|------------------|
| | | Import Value | Dutiable Imports | Customs Duties | Jul-Sep 03-04 | Jul-Sep 02-03 |
| 15 | Animal or vegetable fats | 18.2 | 31.1 | 20.6 | 32.4 | 35.1 |
| 87 | Vehicles | 33.3 | 33.0 | 47.1 | 35.8 | 32.4 |
| 84 | Machinery | -5.6 | 14.3 | 14.5 | 10.3 | 10.3 |
| 39 | Plastic Resins | 19.8 | 21.0 | 21.4 | 18.6 | 18.6 |
| 29 | Chemicals | 26.4 | 17.4 | 19.7 | 9.8 | 9.6 |
| 85 | Electrical Machinery | 39.8 | 27.2 | 29.7 | 13.5 | 13.3 |
| 27 | POL Products | 5.6 | -19.1 | -18.9 | 10.2 | 10.2 |
| 72 | Iron & Steel | 51.9 | 46.8 | 44.3 | 16.0 | 16.3 |
| 9 | Coffee and Tea etc. | 4.1 | -4.1 | -22.8 | 18.9 | 23.5 |
| 38 | Misc. Chemical Products | 18.8 | 18.1 | 6.7 | 11.1 | 12.3 |
| 48 | Paper and Paperboard | 19.9 | 20.6 | 16.1 | 18.0 | 18.7 |
| 32 | Dyes, paints | -3.3 | -4.3 | -4.3 | 18.4 | 18.4 |
| 40 | Rubber products | 25.3 | 26.5 | 17.7 | 14.0 | 15.0 |
| 54 | Man made filaments | 29.8 | 26.9 | 14.9 | 16.5 | 18.3 |
| 30 | Pharmaceutical Products | 13.7 | 13.8 | 11.6 | 10.2 | 10.4 |
| | Sub-total | 16.6 | 15.9 | 18.3 | 17.0 | 16.7 |
| | Others | -10.7 | 13.2 | 5.3 | 12.1 | 13.0 |
| | Grand total | 4.8 | 15.3 | 16.1 | 16.0 | 15.9 |

⁴ These figures are based on data from Custom House, Karachi and Dry Ports within the country. These data represents nearly 96% of trade flows.

Central Excise: Even though the collection of central excise duties declined by 6.4% during Q1:03-04, still the reduced amount was sufficient to meet the target set for the 1st quarter. The net collection declined from Rs. 9.6 billion in Q1:02-03 to Rs. 9 billion in Q1:03-04. The main reasons for this decline are the continuously shrinking base of CED since the last few years in view of the extension in the GST base. This policy option was exercised in the present budget as well when CED was withdrawn from paper and paperboard and wires and cables. Two additional policy decision having far reaching implications for CED collection included reduction of duty on cement by 25%, and the adoption of new rule of levying of CED on natural gas, a shift from volume to heat content basis as mentioned above. The combined negative impact of all these budgetary measures is estimated to be around Rs. 5 billion during FY 03-04.

The month-to-month progress of CED collection indicates that the revenue from this source declined appreciably in July. This sharp fall was although partially arrested in August, but the growth in revenue remained negative as compared to August 2002. However, the collection improved significantly in September mainly due to 25.5% increase in CED from cigarettes and resultantly the overall decline for the quarter remained gentle at 7%.

The performance of CED collection on commodity basis is given in Table 10. The data shows that for cement and POL products the CED collection, as anticipated, declined continuously during the first three months.⁵ The overall reduction in the case of cement was Rs. 450 million, and for POL products Rs. 76.3 million. However, contrary to initial expectations, CED revenue increased from Natural Gas. The information collected through field offices has confirmed that a significant increase in collection has been registered at the Hyderabad Collectorate. On further probing it was observed that

⁵ It may be remembered that most of the POL Products were shifted to CD net during FY 02-03.

four new units have recently started natural gas production and among them the heat content of the Bhitshaw unit at Sehwan Sharif and OMV Sawan unit at Sukkur is very high and of best quality. It appears that the reduction in CED from old units has been more than compensated by the additional production from the new units. CED on beverages was an item that showed a consistent decline throughout the PFY. However, after a further decline in July, the revenue from this source has turned positive since August.

Table 10: Central Excise Major Revenue Spinners

| | FY 03-04 | FY 02-03 | <i>(Rs Million)</i> Difference | |
|------------------------------------|----------|----------|-----------------------------------|---------|
| | | | Absolute | Percent |
| <i>Cigarettes</i> | | | | |
| <i>July</i> | 157.5 | 319.4 | -161.9 | -50.7 |
| <i>August</i> | 1166.0 | 1054.6 | 111.4 | 10.6 |
| <i>September</i> | 1640.8 | 1307.1 | 333.7 | 25.5 |
| <i>Q 1</i> | 2964.3 | 2681.1 | 283.2 | 10.6 |
| <i>Cement</i> | | | | |
| <i>July</i> | 675.4 | 872.3 | -196.9 | -22.6 |
| <i>August</i> | 720.8 | 869.8 | -149.0 | -17.1 |
| <i>September</i> | 771.6 | 875.8 | -104.2 | -11.9 |
| <i>Q 1</i> | 2167.8 | 2617.9 | -450.1 | -17.2 |
| <i>POL Products</i> | | | | |
| <i>July</i> | 223.6 | 249.9 | -26.3 | -10.5 |
| <i>August</i> | 255.4 | 279.4 | -24.0 | -8.6 |
| <i>September</i> | 310.3 | 336.3 | -26.0 | -7.7 |
| <i>Q 1</i> | 789.3 | 865.6 | -76.3 | -8.8 |
| <i>Natural Gas</i> | | | | |
| <i>July</i> | 397.5 | 349.0 | 48.5 | 13.9 |
| <i>August</i> | 369.0 | 371.8 | -2.8 | -0.8 |
| <i>September</i> | 395.2 | 365.5 | 29.7 | 8.1 |
| <i>Q 1</i> | 1161.7 | 1086.2 | 75.4 | 7.0 |
| <i>Beverages</i> | | | | |
| <i>July</i> | 206.9 | 226.8 | -19.9 | -8.8 |
| <i>August</i> | 233.9 | 217.1 | 16.8 | 7.7 |
| <i>September</i> | 207.3 | 169.1 | 38.2 | 22.6 |
| <i>Q 1</i> | 648.1 | 613.0 | 35.1 | 5.7 |
| <i>Total (5 Major Commodities)</i> | | | | |
| <i>July</i> | 1660.9 | 2017.4 | -356.5 | -71.7 |
| <i>August</i> | 2745.1 | 2792.7 | -47.6 | -1.7 |
| <i>September</i> | 3325.2 | 3053.8 | 271.4 | 8.9 |
| <i>Q 1</i> | 7731.2 | 7863.9 | -132.7 | -1.7 |
| <i>Share in Gross CED (%)</i> | 85.9 | 81.7 | | |

Finally, the ex post assessment of the impact of budgetary measures indicates that Rs. 153 million worth of CED revenue has been lost

on account of abolishing of duty on cables and wires and Rs. 102 million have been lost on account of paper and paperboard.⁶ While the revenue loss in terms of cement has been Rs. 450.3 million, there is a revenue gain of Rs. 75.5 million on account of natural gas. Thus, the overall net impact of four budgetary measures has been around Rs. 630 million during the 1st quarter of CFY.

Concluding Observations

The CBR revenue performance has been encouraging during the 1st quarter of CFY. More important is the fact that the performance is broad-based. The collection of three federal taxes, i.e., direct taxes, customs duties, and central excise duties has exceeded their respective 1st quarter targets. The sales tax collection has even though lagged behind its target, but it has been due to technical correction only, as there is no evidence of declining domestic demand or slowdown in sales. This assertion is further supported by the double-digit growth in imports of capital goods and raw material for capital goods. The expansion in customs duty base has been instrumental not only in raising the revenue from this source, it has also contributed significantly towards the overall revenue target and its achievement during the first quarter.

It has also been demonstrated that direct tax has continued its strong performance for the second quarter running. The most important development has been the high level of compliance with income tax returns, which if broad based, may turn out to be an indication of success of the universal self-assessment in income tax. The strong growth of individual taxes also indicates that various tax bases are growing as well, which in turn is a reflection of the health of the economy. This phenomenon if continued will augur well for the long run objectives of attaining respectable growth and stability of the economy with reduced levels of unemployment and poverty.

⁶ This amount was collected during Q1 of FY 02-03. The loss of an exact amount assumes that the production value has remained the same during the period under consideration.

II

Industry profile: Cement Industry in Pakistan⁷

Introduction

Cement is one of the essential industries of a country. Besides playing key role in the development of physical infrastructure and generating economic activity in a number of downstream industries especially construction, it also contributes significantly towards government receipts. The 24 production plants currently operating in the country have a total installed capacity of 17.7 million tons, which is more than sufficient to meet the domestic demand. Of these operational plants, 20 units are established within the private sector. Twenty-one units are listed with the Karachi Stock Exchange.

Historical Profile of Cement Industry

The cement industry in Pakistan has grown gradually with the passage of time. At the time of independence there were only four units with total production capacity of nearly half a million tons per annum. By 1972 the number of cement plants increased to 14 and the production capacity also increased to 2.5 million tons. Both public and private sectors took initiative to establish new plants. As was the case for other industries, the cement industry was also nationalized in 1972 and the State Cement Corporation of Pakistan (SCCP) was established and given the responsibility to manage the production of cement in the country. Considering the higher cement demand as compared to supply, cement import was also allowed in FY 76-77 that continued until FY 94-95. With a change in policy of state control over industrial units, the state owned cement plants were also put-up for privatization along with other industries. The private sector was allowed to invest in the cement manufacturing.

⁷ This study has been prepared by Dr. Ather Maqsood Ahmed, Member and Mr. Naeem Ahmed, Research Officer, Fiscal Research Wing, CBR.

Consequently, the role of SCCP as market leader vanished gradually and currently it owns only four plants, of which two have been closed down on efficiency and profitability grounds.

In view of the higher demand during the period of de-regulation and liberalization, a number of new units were set up and many others invested heavily to increase their existing production capacity. As a result, the production capacity has reached 17.7 million tons per annum during 2003. Surprisingly the recent increase in the installed capacity has outpaced the increase in demand with the result that the cement industry is operating with an idle capacity of almost 50%.

Production Process of Clinker/ Cement

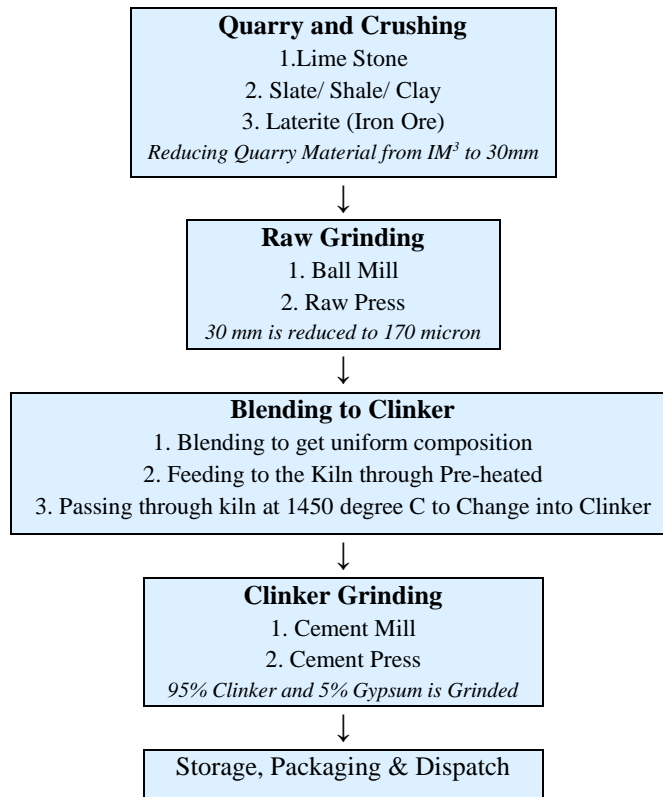
The production of clinker/ cement is highly energy-intensive.⁸ It involves chemical combination of various inputs that are abundantly and cheaply available in Pakistan and therefore the country enjoys comparative advantage in its production. The chemical analysis of different materials used in its production process is presented in Table 1. However, it is important to mention that the desired physical and chemical properties of cement can be obtained by changing the percentages of these basic chemical components.

Table 1: Chemical Analysis of Different Inputs in Cement Production

| Parameters | Lime Stone | Slate | Laterite | Kiln Feed | Clinker | Cement |
|--|------------|-------|----------|-----------|---------|--------|
| Silicon Dioxide (SiO ₂) | 4.885 | 69.74 | 55.00 | 13.8 | 22.49 | 21.9 |
| Aluminum Oxide (Al ₂ O ₃) | 1.623 | 18.14 | 12.50 | 3.92 | 5.71 | 5.50 |
| Iron Oxide (Fe ₂ O ₃) | 1.580 | 6.12 | 35.54 | 2.45 | 3.52 | 3.40 |
| Calcium Oxide (CaO) | 48.35 | 0.80 | 0.12 | 42.54 | 64.86 | 63.90 |
| Magnesium Oxide (MgO) | 0.85 | 0.25 | 0.66 | 0.45 | 0.89 | 0.87 |
| Sulphur Trioxide (SO ₃) | 0.001 | 0.02 | 0.17 | 0.001 | 0.20 | 2.50 |
| Sodium Oxide (Na ₂ O) | 0.11 | 0.88 | 0.12 | 0.22 | 0.23 | 0.14 |
| Potassium Oxide (K ₂ O) | 0.24 | 1.10 | 0.35 | 0.78 | 0.78 | 0.65 |

⁸ The energy use depends on whether wet, semi-dry or dry process is used in the production of cement. Since the wet process consumes more energy as compared to the dry process, its share in total installed capacity has declined drastically from over 90% in 1960s to 12% in 2002-03. See 'Cement Industry in Pakistan' prepared by the Expert Advisory Cell, Islamabad (2002-3).

The several stages of the cement production process involve quarrying and crushing, raw grinding, blending, preheating, feeding to kiln, clinker storage, cement/ clinker grinding, storage and packing. The graphical exposition of these processes is as follows.⁹



Cost of Production of Cement

The production cost of cement (including depreciation but excluding government taxes) is estimated to be around Rs. 1951 per ton, provided the capacity utilization rate is 100%.¹⁰ Nearly 76% of the variable cost or 54% of total cost is consumed by energy (fuel and

⁹ Cement can be produced by utilizing dry, semi-dry or dry process. For each of these processes, heat consumption varies significantly.

¹⁰ See Expert Advisory Cell (2002-03). An earlier study estimated this cost to be around Rs. 1641 per ton excluding depreciation and government taxes. See 'Input Cost and Corporate Tax Structure: An Analysis of Trends in SAARC Region' – a joint study by the Institute of Cost and Management Accountants of Pakistan and the Federation of Pakistan Chamber of Commerce and Industry (2001).

power), 14% of total cost by administrative and financial expenses, 12% by raw material, 9% by depreciation, and 3% by wages and salaries. With the addition of taxes and rebates to stockists, the cost of production during FY 02-03 varied between Rs. 3800 and Rs. 4300 per ton for different cement manufacturers depending upon the location of their plant in the country. Since the sale price per ton was invariably higher than the cost of production, including taxes, therefore cement manufacturers were generally reaping 3% to 10% profit on each ton of cement sold in the market [EAC (2002-03)].

In an effort to further reduce the cost of production, most of the cement plants operating on furnace oil have started to switch to coal fired plants as the price of furnace oil has escalated rapidly in recent years. Presently, out of 24 units, 5 have fully converted to coal firing plants. These include D.G. Khan, Pioneer, Gharibwal, Bestway, and Dandot. At the same time the degree of conversion of other plants is as follows: Pakland 95%, Dadabhoy 90%, Zealpak 80%, Maple Leaf 70%, FECTO 50%, Charat 45%, Nizampur and Askari 40%, Kohat 30%, and Attock 25%. The Essa cement plant has completed 70% of conversion work of kiln-II, Saadi has completed 90% of work on line-1 and Lucky has converted 100% and 50% of work on its lines B and A, respectively.¹¹ This detailed description indicates that the cement manufacturers are consciously striving to reduce the comparative cost of production through cheaper utilization of inputs, especially heating fuel even though this transition is not as smooth in terms of availability of coal, its price, and environmental effects.

Production and Revenue

The historical data confirms that with a steady increase in cement production, government revenue has also increased. For example, the collection on account of central excise duties (CED) has jumped from Rs.15 million in FY 60-61 to Rs. 10,812 million in FY 02-03 –

¹¹ See the Experts Advisory Cell's prepared document 'Utilization of Coal in Cement Industry' for further details.

an average annual increase of 23%. Similarly, sales tax, which was levied on clinker until FY 96-97, and later on levied on cement, also registered an increase in collection from Rs.1.4 billion in FY 90-91 to Rs. 3.6 billion in FY 02-03. A brief summary of the production and revenue is given in the Table 2 in the following.

Table 2: Cement Production and Revenue Collection

| Years | Production ('000'Tons) | Increase/Decrease (%) | CED & ST Collection (Rs. Million) | Increase/Decrease (%) |
|---------|------------------------|-----------------------|-----------------------------------|-----------------------|
| 1990-91 | 7745815 | 3.9 | 4447 | |
| 1991-92 | 8078993 | 4.3 | 5350.4 | 20.3 |
| 1992-93 | 8370880 | 3.6 | 5494.4 | 2.7 |
| 1993-94 | 8139881 | -2.8 | 6773.3 | 23.3 |
| 1994-95 | 8428559 | 3.5 | 9955.7 | 47.0 |
| 1995-96 | 9542407 | 13.2 | 10694.2 | 7.4 |
| 1996-97 | 9536059 | -0.1 | 14802.1 | 38.4 |
| 1997-98 | 9363846 | -1.8 | 14225.6 | -3.9 |
| 1998-99 | 9635363 | 2.9 | 14879.1 | 4.6 |
| 1999-00 | 9314038 | -3.3 | 13954.2 | -6.2 |
| 2000-01 | 9673602 | 3.9 | 12587.9 | -9.8 |
| 2001-02 | 9934854 | 2.7 | 13871.8 | 10.2 |
| 2002-03 | 10232899* | 3.0 | 14405.9 | 3.9 |

* Estimate

Fiscal Measures

Over the years a number of tax policy and administrative measures have been introduced to attract investment and facilitate growth of the cement industry. These include rationalization of central excise duty rates to minimize tax burden and promote competitiveness, the introduction but later on withdrawal of CED on the basis of capacity system of the plants, and sales tax audit based on risk management criterion as sales tax is now levied on self-assessment basis.

(i) *Tax Rate Structure:* While maintaining uniformity in the sale tax rate structure, the currently applicable rate of GST on cement is 15%, the CED rate for cement on the other hand has varied diversely during the 1990s to rationalize the CED duty structure. The most recent CED rate profile is as follows:

| Year | CED Rate | Year | CED Rate |
|---------|-----------------|---------|-----------------|
| 1998-99 | Rs. 1400 per MT | 2001-02 | Rs. 1000 per MT |
| 1999-00 | Rs. 1400 per MT | 2002-03 | Rs. 1000 per MT |
| 2000-01 | Rs. 1000 per MT | 2003-04 | Rs. 750 per MT |

The figures show that whereas the direct consequence of slashing of CED rates by 28.6% between FY 99-00 and FY 02-03 has been the reduction in CED revenue by about 22% even though the production of cement has kept on increasing at an average rate of 3.2%.

(ii) *The Capacity System:* A comparative analysis of levying of CED in the eras of pre- and post-capacity system suggests that even though CED rate increased by 28.6% in FY 92-93, the CED collection declined by 2.7% as compared with the previous year's increase of 19.9%. Surprisingly, the decline in revenue was accompanied by an increase in production by 3.6%. It seems that the terms of capacity system had tilted the odds in favor of the cement manufacturers, who unfortunately did not pass on the benefit of the change either to the consumers, as the prices did not decline during this period, or to the government in the form of higher tax revenue. Consequently, the situation forced the government to revert back to the old system to protect its revenues and the interest of the public at large [Table 3].¹²

Table 3: The Impact of Capacity System on Production and Collection

| Years | Production (000 Tons) | Growth (%) | CED Collection (Rs. Million) | Growth (%) | Average Rates | Growth (%) |
|-------|--------------------------|---------------|------------------------------------|---------------|------------------|---------------|
| 89-90 | 7454515 | | 2501.4 | | 327 | |
| 90-91 | 7745815 | 3.9 | 3084.1 | 23.3 | 395 | 20.8 |
| 91-92 | 8078993 | 4.3 | 3699.1 | 19.9 | 395 | 0.0 |
| 92-93 | 8370880 | 3.6 | 3600.7 | -2.7 | 508 | 28.6 |
| 93-94 | 8139881 | -2.8 | 4129.5 | 14.7 | 510 | 0.4 |

¹² According to the cement manufacturers association, they have now implemented an independent audit system to monitor production facilities at cement plants round the clock to effectively prevent dispatch of cement without payment of CED.

(iii) *Sales Tax Audit*: With the introduction of GST, an elaborate system of audit ensures compliance of sales tax. The routine audit of any registered person/ unit during the financial year is conducted under section 25 of the Sales Tax Act, 1990. However, the investigative audit under section 38 could be conducted in any number of times during the financial year if deemed necessary. Within this setup, the historical evidence of sales tax audit reveals that during three recent years, i.e., between 2001 and 2003, 35 audits of cement unit were conducted. Of them, 11 audits were carried out in 2001, 18 in 2002, and 6 in 2003. The unit-wise details of the audit are given in Table 4.

Table 4: Details of Sales Tax Audit of Cement Plants

(Rs. million)

| UNIT NAME | Year | # of audits | Detection | Recovery |
|---|------|-------------|--------------|-------------|
| Maple Leaf Cement Factory Ltd Phase II, | 2001 | 2 | 18.75 | 0.00 |
| Zeal Pak Cement Factory Ltd. | | 2 | 2.25 | 0.27 |
| Thatta Cement Company Ltd. | | 1 | 0.00 | 0.00 |
| Pakistan Slag Cement Ind. (Pvt) Ltd. | | 1 | 0.00 | 0.00 |
| Javedan Cement | | 2 | 4.90 | 0.00 |
| Charat Cement Co. Ltd | | 1 | 0.00 | 0.00 |
| Lucky Cement Ltd. | | 1 | 1.75 | 0.00 |
| Army Welfare Trust Plant at Nizampur | | 1 | 13.96 | 0.00 |
| Total | | 11 | 41.56 | 0.27 |
| Maple Leaf Cement Factory | 2002 | 1 | 0.79 | 0.00 |
| Pioneer Cement Ltd. | | 1 | 29.81 | 0.00 |
| Attock Cement Pakistan Ltd. | | 1 | 1.07 | 0.58 |
| Dadabhoi Cement Industries Ltd. | | 1 | 0.00 | 0.00 |
| Lucky Cement Ltd. | | 2 | 24.07 | 9.51 |
| Kohat Cement Co Ltd | | 3 | 9.43 | 0.00 |
| Saadi Cement Limited | | 2 | 0.94 | 0.00 |
| Charat Cement Co Ltd | | 2 | 9.56 | 0.56 |
| Army Welfare Trust at Nizampur | | 1 | 7.20 | 0.00 |
| Gharibwal Cement Ltd. | | 1 | 16.99 | 16.35 |
| Dandot Cement Ltd, | | 1 | 12.89 | 11.82 |
| Bestway Cement Limited | | 1 | 18.23 | 0.00 |
| Fecto Cement Limited | | 1 | 0.00 | 0.00 |
| Total | | 18 | 129.9 | 38.2 |
| Zeal Pak Cement Factory Ltd. | 2003 | 1 | 2.83 | 0.0 |
| Pakistan Slag Cement Ind. (Pvt) Ltd. | | 1 | 53.17 | 0.0 |
| Mustahkam Cement Ltd. | | 1 | 0.08 | 0.0 |
| Dandot Cement Ltd. | | 1 | 25.08 | 3.0 |
| Gharibwal Cement Ltd. | | 1 | 23.91 | 0.0 |
| Fauji Cement Company Ltd. | | 1 | 0.00 | 0.0 |
| Total | | 6 | 105.1 | 3.0 |

It should be evident that it is not necessary that every unit be audited every year as the selection criterion is based on risk management. This is so because audit selection is not sector specific. However, with the exception of few units where there is no detection, the cumulative amount detected through these audits has been Rs. 276.6 million, of which Rs. 41.5 million only or 15% has been recovered. This shows that the recovery rate has been quite low. A further analysis regarding the number of audits and the geographical location of the cement plants does not present a balanced picture, as the audit to unit ratio is 2.3 for the NWFP but only 0.3 for the Balochistan province [Table 5].

Table 5: Geographical Location of Units and Audits Conducted (January 2001 and April 2003)

| Province | No. of Units | Audit Conducted |
|-------------|--------------|-----------------|
| Punjab | 8 | 11 |
| Sindh | 7 | 9 |
| NWFP | 6 | 14 |
| Balochistan | 3 | 1 |
| Total | 24 | 39 |

Persisting Concerns

It is rather strange that key players concerning cement industry, i.e., manufacturers, consumers, and the government are found entangled in issues of diverse nature when the whole situation is analyzed in a systematic manner. Some of the major concerns are as follows.

Notwithstanding the nature and the magnitude of the investment in the cement industry, especially during the 1990s, the production of cement has not grown at the same pace. Until very recently the industry has been operating at around 50% of its installed capacity. Lower than anticipated domestic demand and failure to enhance cement export due to stiff competition from neighboring countries, the manufacturers started to manipulate retail price by regulating its supply. A cartel like situation was formed in 1998 that continues to prevail. As a consequence, the retail price of cement initially shot-up

by about Rs. 100 per bag and continues to remain higher than the market-clearing price. Incidentally, the price fell sharply when the cartel fell apart temporarily during FY 02-03 only to reemerge with its distortions in recent months.

The cement manufacturers have always insisted that taxes are too heavy to operate on profitable/ competitive basis. However, as analyzed earlier, the government has repeatedly slashed CED rates, the most recent being further reduction in the CED rate by 25% in the budget 03-04, but with a marginal impact on the price of cement. The pre- and post-budget information on retail price has been gathered through market survey. Table 6 shows that the average price per bag was as low as Rs. 190.2 when the cartel was not operating, but jumped to Rs. 227.9 before the announcement of the budget in June 2003. The prevailing price in September 2003 is Rs. 223.8, which shows a difference of only 1.8% than the pre-budget price, notwithstanding a 25% reduction in the CED rate.

Table 6: Average Retail Price of Cement

| Date | Price (Rs. per bag) |
|------------|---------------------|
| 06-03-2003 | 190.2 |
| 03-04-2003 | 212.0 |
| 29-05-2003 | 227.9 |
| 19-06-2003 | 226.1 |
| 24-07-2003 | 225.8 |
| 13-08-2003 | 224.2 |
| 21-08-2003 | 224.4 |
| 28-08-2003 | 223.8 |
| 11-09-2003 | 223.8 |

The prevalence of high retail price is even more disturbing in view of the fact that most of the cement plants have already converted to coal, a much cheaper heating fuel than furnace oil, thereby reducing the cost of production. Thus, the continuation of higher than market-clearing price is viewed by consumers as excessive profitability of the cement manufacturers that requires corrective measures.

Even though the Monopoly Control Authority (MCA) in 1998 had exercised its power to break the collusive arrangement between cement manufacturers, but it was not a successful attempt, partly due to weak enforcement of the writ of the law and partly due to political pressures.¹³ With the reemergence of the cartel, the MCA has again issued notices to the manufacturers but to no avail. Simultaneously, two meetings have been held in August 2003 between the Ministry of Industries and the Cement Manufacturers to review the possible impact of recent duty reduction. The view of the Ministry that the manufacturers have not passed on the benefits of duty reduction to the consumers appears to have been acknowledged with a promise to lower the prices of cement within a month. Not only there is a need to keep this promise, but also the whole episode requires careful monitoring by the relevant authorities.

Concluding Remarks

There are a number of unanswered questions regarding cement industry in Pakistan and each one of them requires further probing. The first question pertains to the quality of the feasibility studies and their approval by the concerned departments before the establishment of industrial units. One wonders why in the case of cement manufacturing feasibility studies went so terribly wrong to create an idle capacity of nearly 50%? Who is responsible for assessing the current and future demand and its trade flows? Why industrial units are sanctioned when there is no domestic demand for the product? Is there lack of coordination at the national and provincial levels that results into this kind of mismatch?

It is also amazing to see how conveniently the indigenous capability to build cement plants has been wasted in favor of imported plant

¹³ The MCA intervened under the Monopolies and Restrictive Trade Practices (Control and Prevention) Ordinance, 1970 and directed cement manufacturers to break their cartel, reverse the cement price to pre-October 98 level and to remove the restrictions on the utilization of productive capacity with immediate effect. The manufacturers did not comply with these orders on legal pretexts, even though they were later fined for non-compliance.

and machinery, which is not only costly but also requires foreign exchange. Moreover the idle capacity of the imported equipment is even more distressing as it creates distortions in the system, which leads to exploitation.

All across the world it is common to observe that firms have incentives to acquire market power – the discretionary power to control prices – either through collusive arrangements or through erecting artificial barriers. Such practices are defeated through the application of ‘competition policy’ duly supported by the required legislation.¹⁴ Additionally, the nature of factors, explicit or implicit, that create impediments in the enforcement of law are carefully assessed to undertake remedial measures. In this respect, the question is does MCA have enforcement powers? It is been five years that the initial judgment was passed by the Authority but the matter is still lingering.

Besides government departments to share the blame, the onus also falls on the manufacturers of cement for the prevailing market situation. Almost all of the available evidence, either related to reduction of government taxes or switching of plants to cost effective mode of production and drastic reduction of retail price of cement when the cartel appears to be falling apart, point to the fact that something is seriously wrong with the supply situation. There is a credibility problem on the part of the manufacturers. If, as a group, they think they have valid reasons to maintain higher retail prices, they will have to come clean to explain their position. After all, the consumers are not all that naïve not to understand the real factors behind their exploitation.

From consumers’ side, it is valid to ask who is there to protect their interests. Along side the government who has to ensure that

¹⁴ See ‘A Framework for the Design and Implementation of Competition Law and Policy’, a joint publication of the World Bank and OECD (1999), Washington D. C.: The World Bank.

consumers face market rather than monopoly prices. What has been the scope of work of such institutions as Consumers Protection Agency, if there is any? While the developed economies do have strong advocacy groups to safeguard the interests of consumers, the situation in Pakistan is as murky as it could be.

Three additional concerns that are essentially consequential in nature but require mentioning. The first relates to the switching of cement plants from furnace oil to coal fired plants and in this respect the environmental cost of this substitution needs to be ascertained.¹⁵ It is a common understanding that the burning of coal with sulphur content has serious environmental consequences. There are, nonetheless, techniques available whereby sulphur emission could be reduced to a significant level. However, this requires that a foolproof monitoring system be in place to avoid major environmental catastrophe.

It is also necessary that the required infrastructure, i.e., road/ railway be in place at the earliest to meet future coal needs of the cement and other industries relying on cheaper fuel. A consistent and cost effective supply of coal will have to be ensured so that industrial structure built around locally available cheap heating fuel continues its production without worrying about input constraints. Furthermore, price stability of coal will have to be maintained.

Finally, revenue stability for the government is yet another area of concern. The evidence suggests that the revenue cost of slashing of CED has been fairly significant. This loss may be compensated if the plants start operating at full capacity. However, until such time, there is a possibility that this budgetary measure may result into revenue shortfall.

¹⁵ The Environment Report on Cement Sector prepared in September 2000 under the Environmental Technology Program for Industry (ETPI) is not up-to-date as far as the environmental cost of coal-fired plants is concerned. This aspect needs to be studied on priority basis.

III

Pakistan's Experience with WTO Agreements on Market Access¹⁶

Introduction

WTO Agreements have posed multi-faceted challenges for most of the developing countries due to their extensive coverage and plethora of documentation. While the agreements related to customs valuation, intellectual property rights (IPRs), trade in services, and issues related to investment, agriculture, textile and clothing, and sanitary measures have been designed to provide opportunities for unrestricted international trade flows, they have serious implications for developing countries (D_gCs), including Pakistan. The anticipated benefits of trade have been marginal so far despite the fact that the agreements call for greater market access through reduction in tariff and non-tariff barriers. One of the reasons for this malaise is that while D_gCs have increasingly acceded to the requirements of the agreements, the flow of exports from these countries is being restricted by the developed world through strict trade defense measures. There is no denying that ever since its adoption in 1995, anti-dumping option has been exercised rather extensively by the USA and the EU countries and so is the evidence related to countervailing duties, subsidies, and safeguard measures [WTO, Annual Report (2003)]. This tendency seems to be continuing even today, albeit at a slower pace. The recent debacle at the Cancun Conference has once again raised questions about realization of the estimated benefits of liberalization and globalization, as the so-called Quad group of major importers (the USA, the EU, Canada, and Japan) is still not ready to withdraw protective barriers against imports of agriculture and textile from the developing world.

¹⁶ *Authors:* Dr. Ather Maqsood Ahmed, Member (FR&S) and Mr. Mir Ahmed Khan, Statistical Officer (FR&S), CBR. They are grateful to Mr. Riaz A. Malik, Chairman CBR for insightful comments.

The present study seeks to focus on Pakistan's experience with market access initiatives under WTO Agreements. With a brief review of the existing tariff structure and trade defense measures, the paper concentrates on the enactment of trade defense laws in Pakistan and their enforcement.

The Binding Structure of Tariffs

Interestingly, there is no legally binding agreement that sets out the targets for tariff reductions, i.e., by what percentage they were to be cut as a result of the Uruguay Round. However, at the end of the Uruguay Round negotiations, individual countries had listed their commitments in schedules annexed to *Marrakesh* Protocol to the GATT 1994, which became the lengthy binding agreement for the reduced tariff rates [WTO (1999)].¹⁷

Tariff Reduction and Rationalization in Pakistan

Until recently Pakistan's taxation system was overwhelmingly dependent on the international trade taxes including import and export duties. Besides being a sure source of government revenues, high rates of duties were used to protect domestic industry from unhealthy international competition. However, this high level of protection not only generated gross inefficiencies in the system as the quality of the goods produced by the domestic industry suffered badly, but it also became a major impediment to growth through its adverse impacts on exports and further industrialization.

To circumvent these concerns, broad based tariff reform program was initiated in the second half of the 1980s. Since then the maximum tariff on import duties has been curtailed gradually from 125% in FY 90-91 to 80% in FY 93-94 and 65% in FY 95-96. Currently, the maximum tariff rate is 25% and the number of slabs has also been reduced to only four i.e., 5%, 10%, 20%, and 25%.

¹⁷ See 'Trading into the Future: The World Trade Organization', revised second edition, April 1999.

With the revision of statutory rates, the effective tariff rate, defined as collection of net customs duties relative to *dutiable* imports, declined from 72.7% in FY 90-91 to 15.8% in FY 02-03. Similarly, the effective rate based on *total* imports also declined from 29.5% to 9.8% during this period. As a result, the share of customs duty revenue in federal tax receipts has come down from 46% in FY 90-91 to only 15% in FY 02-03 (Table 1). The revenue loss emanating from this change has already been compensated by the introduction of broad based consumption tax in the shape of GST. With these changes, Pakistan’s tax structure is now redesigned on modern lines and the country is well placed for full implementations of the International Agreements on trade.

Table 1: Tariff Structure, Customs Duties and Effective Rates

| YEAR | Max. Tariff Rate (%) | Net Customs Duties (Rs. Million) | Share of CD in CBR Revenue (%) | Effective Rates (%) wrt | |
|---------|----------------------|----------------------------------|--------------------------------|-------------------------|---------------|
| | | | | Dutiable Imports | Total Imports |
| 1988-89 | 125 | 42,362 | 47.0 | 61.8 | 31.2 |
| 1989-90 | 125 | 48,584 | 46.6 | 69.6 | 32.6 |
| 1990-91 | 125 / 95 | 50,528 | 45.7 | 72.7 | 29.5 |
| 1991-92 | 95 | 61,821 | 44.2 | 65.6 | 26.9 |
| 1992-93 | 90 | 61,400 | 40.1 | 38.3 | 23.7 |
| 1993-94 | 80 | 64,240 | 37.2 | 38.3 | 24.9 |
| 1994-95 | 70 | 77,653 | 34.3 | 35.7 | 24.2 |
| 1995-96 | 65 | 88,916 | 33.2 | 33.2 | 22.4 |
| 1996-97 | 65 | 86,094 | 30.5 | 23.6 | 18.5 |
| 1997-98 | 45 | 74,496 | 25.4 | 22.0 | 17.1 |
| 1998-99 | 45 | 65,292 | 21.2 | 18.4 | 14.0 |
| 1999-00 | 35 | 61,659 | 17.8 | 17.8 | 11.6 |
| 2000-01 | 30 | 65,047 | 16.6 | 16.8 | 10.4 |
| 2001-02 | 25 | 47,818 | 11.8 | 11.8 | 7.5 |
| 2002-03 | 25 | 69,100 | 15.0 | 15.8 | 9.8 |

A Distinction Between Applied and Binding Tariff

Binding tariffs, and applying them equally to all trading partners – the most favored nation treatment or MFN – is key to the smooth flow of trade in goods. The market access schedules are not simply announcements of tariff rates rather they represent commitments with the WTO by individual countries regarding their respective

tariff structures. In the case of developed countries, these binding commitments of rates – also known as the bound (tariff) rates – are generally the rates actually charged, thus reducing the distinction between applied and bound rates. For developing countries bound rates are somewhat higher than the applied rates, so the bound rates serve as ceilings, which are difficult to change.

Notwithstanding the fact that the applied and bound tariffs have largely coincided and the average tariffs are also low, tariff peaks and escalation in developed countries are major impediments towards unrestricted flow of exports from D_gCs. The evidence shows how tariff rates increase progressively from one stage of processing to another. While unfinished products face lowest tariff rates, the highest rates are applied to semi-finished and finished products, thus depriving D_gCs of their comparative advantage in the exports of agriculture and agro-based finished products.¹⁸

Table 2: Tariff Escalation in the Quad Countries & Pakistan

| | Stages of Processing | Food, Beverages & Tobacco | Textile & Leather Products | Chemicals | Basic Metal | All Sectors |
|------------------|----------------------|---------------------------|----------------------------|-----------|-------------|-------------|
| USA 2001 | 1 | 3.20 | 2.20 | 2.00 | 0.30 | 2.20 |
| | 2 | 9.00 | 9.80 | 4.60 | 2.10 | 5.20 |
| | 3 | 13.10 | 10.30 | 4.10 | 2.50 | 5.70 |
| Canada 2002 | 1 | 7.90 | 1.00 | 1.50 | 0.00 | 3.90 |
| | 2 | 6.80 | 7.00 | 2.90 | 0.90 | 3.90 |
| | 3 | 34.30 | 13.50 | 4.70 | 3.00 | 8.90 |
| EU (15) 2002 | 1 | 12.40 | 0.90 | 1.70 | 0.00 | 7.30 |
| | 2 | 19.10 | 6.70 | 4.50 | 1.90 | 4.90 |
| | 3 | 18.80 | 9.70 | 3.80 | 0.00 | 7.00 |
| Japan 2002-03 | 1 | 25.40 | 9.80 | 2.50 | 0.40 | 14.60 |
| | 2 | 30.30 | 6.80 | 2.80 | 1.10 | 4.90 |
| | 3 | 22.60 | 12.00 | 2.00 | 3.00 | 7.80 |
| Pakistan 2001 | 1 | 12.10 | 10.10 | 13.20 | 14.70 | 11.80 |
| | 2 | 19.20 | 23.70 | 13.90 | 15.40 | 17.50 |
| | 3 | 29.20 | 29.20 | 21.10 | 30.00 | 23.60 |

Note: Tariff Escalation by 2-digit ISIC Industry Code.

Source: WTO Annual Report (2003)

¹⁸ A number of studies have shown that undue restrictions not only promote rent seeking activities, but the net welfare loss is also substantial, see R. Feenstra (1995) 'Estimating the Effects of Trade Policy' in Handbook of International Economics, Volume III, Amsterdam: North Holland., pp 1553-1595.

Binding Structure of Tariff: The argument in favor of binding structure of tariff is that it reduces uncertainties related to profitability of traders and investors by providing substantially higher degree of assurance about market security and access. While most of the developed countries have bound close to 100% of their industrial tariff lines, for the developing countries as a group this percentage has increased from 21% to 73% (Table 3). As far as the tariff structure in Pakistan is concerned, nearly 32% of the product lines were bound since FY 95-96 at various rates. However, with the application of a formula whereby bound rates are set at applied rates plus 50, this percentage has risen to 98.4, thus ranking Pakistan amongst the top in the developing countries group. The only exceptions to the binding structure are commodities that lie outside the currently applicable four slabs.

Table 3: Scope of Bindings, Average and Bound Tariff Rates on Industrial Products for Selected WTO Members

| | Share of Bound Lines (%) | Average Final Bound Rate | Average Applied rate | Year |
|--------------|--------------------------|--------------------------|----------------------|---------|
| Canada | 100.0 | 5.7 | 4.2 | 2002 |
| USA | 100.0 | 4.0 | 4.4 | 2001 |
| EU | 100.0 | 4.0 | 4.1 | 2002 |
| Japan | 98.7 | 3.8 | 3.9 | 2002-03 |
| Australia | 95.5 | 11.6 | 4.7 | 2001-02 |
| Argentina | 100.0 | 31.8 | 13.4 | 2000 |
| South Africa | 95.7 | 18.1 | 10.9 | 2002 |
| Bangladesh | 0.9 | 50.0 | 21.9 | 1999-00 |
| India | 68.2 | 36.2 | 31.0 | 2001-02 |
| Pakistan | 36.5 | 36.0 | 20.1 | 2001-02 |

Source: Table II.1, WTO Annual Report (2003)

Trade Defense Measures

The WTO even though takes a clear stand on freer trade through the removal of tariff and non-tariff barriers, there are nonetheless certain exceptions to these rules. The Organization provides a whole host of effective tools in the form of anti-dumping, countervailing duties and safeguard measures that allow member countries to protect their

economies temporarily against the inflow of illegal and cheaper imports threatening the domestic economy. The WTO Agreements related to trade defense measures and Pakistan's initiatives on these matters are discussed in the following.

Agreement on Anti-Dumping Measures: Dumping being a debatable issue has attracted enormous attention across the world. Dumping refers to price discrimination between national markets, i.e., when an exporter sells a product for export to the importing country at a lower price than the price at which the same product is sold on its own or other markets. Dumping is undertaken with three main objectives of getting rid of surpluses, capturing new markets, and to reap benefits of scale economies. The literature distinguishes between three types of dumping: (a) persistent dumping which occurs when the elasticity of demand for a product in the world market is higher than the elasticity of demand in the domestic market; (b) predatory dumping which refers to temporary price discrimination to attain monopoly status; and (c) sporadic dumping to get rid of excess supply due to over production. Dumping even though raises consumer welfare of the importing country, at least in the short run, but since it also hurts the producers, the outcome is not Pareto-optimal.

Trade defense measures such as anti-dumping is one of the tools permitted under WTO on the pretext of protecting domestic industry including newly established and infant industry, which require time to flourish. Article VI of GATT allowed countries to take action against dumping.¹⁹ However, for establishing an anti-dumping case, there must be a proof of dumped imports, injury to the domestic industry and establishment of cause and effect relationship between them. When these conditions are proven beyond any shadow of

¹⁹ There are many different ways of calculating but the agreement narrows down the range of possible actions. Usually, the price prevailing in exporter's domestic market or price charged by the exporter in another country or a calculation exporter's production cost including other expenses and normal profits is used to calculate product's 'normal value'.

doubt, then anti-dumping duties can be levied to increase the price of imported good vis-à-vis the domestic goods. It is important that anti-dumping measures must expire five years after the date of imposition, unless an investigation shows that ending the measure would lead to injury. Similarly, anti-dumping investigations are to end immediately in cases where the authorities determine that the margin of dumping is insignificantly small.

Anti-Dumping Investigations and Imposition of Measures: Ever since its permission under WTO in 1995, the number of the ‘initiated’ anti-dumping investigations has increased sharply, which raises concerns about the appropriate use of these provisions. The number of initiations notified by the members to WTO during 1995-2001 has been 1868 (Table 4). Of these the number of cases against whom measures have been imposed are 1059 that constitutes 57% of the initiated cases. The largest user of anti-dumping provisions during the past seven years are: USA (257), India (248), the EU (247), and Argentina (166). The countries most affected by these investigations are China who is facing 261 cases, the Republic of Korea (139), USA (103) and Taiwan (96) [WTO Annual Report (2003)]. The investigations are most frequently targeted against base metals and articles thereof (38% of the initiations in 2001), chemicals (17%), and rubber and rubber products (14.4%). Within the base metal category, nearly 85% of the investigations initiated in 2001 were related to steel products. Pakistani products, especially textile exports have also been at the receiving end. In the past the EU has opted for anti-dumping investigations and levy of duty on grey cloth; Japan on cotton yarn, and USA on cotton towel.²⁰

Anti-dumping Law & its Implementation in Pakistan: Pakistan has already promulgated Anti Dumping Ordinance, 2000 in December 2000. The National Tariff Commission (NTC) has been empowered

²⁰ A recent attempt by the EU to impose anti-dumping duty on bed linen has been successfully negotiated between the two trading partners to reach at an amicable understanding on trade flows.

to exercise anti-dumping duties based on proper investigations in line with the Ordinance. Similarly, the Ministry of Commerce has been made responsible for assisting domestic exporters to defend their cases of anti-dumping. As far as the application of the anti-dumping law is concerned, NTC has already imposed anti-dumping duties against South Africa on tinplate in November 2002, against France and Indonesia on serbitol 70% solutions in July 2003, and Taiwan on glacial acetic acid in September 2003.

Table 4: Anti-Dumping Initiations of Investigations and Measures 1995-2001

| Year | Number of Initiations | Number of Measures | Measures Relative to Initiations (%) |
|--------------|-----------------------|--------------------|--------------------------------------|
| 1995 | 157 | 118 | 75 |
| 1996 | 224 | 84 | 38 |
| 1997 | 243 | 119 | 49 |
| 1998 | 254 | 162 | 64 |
| 1999 | 355 | 182 | 51 |
| 2000 | 288 | 235 | 82 |
| 2001 | 347 | 159 | 46 |
| Total | 1868 | 1059 | |

Source: WTO Annual Report (2003)

Agreement on Subsidies and Countervailing Measures: This agreement not only disciplines the use of subsidies, but it also regulates the actions countries can take to counter the effects of subsidies. The agreement introduces the concept of specific subsidy, whereby a subsidy available to an enterprise, industry, group of enterprises, or group of industries in a country that gives the subsidy. It also distinguishes between prohibitive and actionable subsidies. From definitional standpoint the extra duty that is charged on ‘proven’ subsidized imports is regarded as countervailing duty.

Investigations and Imposition of Measures: Across the world countervailing measures are used more sparingly than anti-dumping measures. The evidence suggests that only 27 initiations pertaining to the subject were reported by the member countries during 2001, of which USA has initiated 18 cases, and the EU (6). The main target of these initiations was India with 18 cases against its name.

Enactment and Application of Law in Pakistan: To bring conformity with the WTO agreement, Pakistan in January 2001 promulgated the Countervailing Duties Ordinance, 2001 to ensure protection to domestic producers against illegal subsidized exports. NTC has the enforcement powers to impose countervailing duties. As far as the implementation of the countervailing measures against Pakistan is concerned, USA and South Africa have targeted only two products, i.e., shop towel and bed linen for levying countervailing duties.

Agreement on Safeguard Measures: Agreement on Safeguard Measures under Article 19 of GATT was always available, but used very infrequently. Under the WTO Agreement, a member may restrict imports of a product temporarily, i.e., take safeguard action, if its domestic industry is injured or threatened with injury caused by a surge in imports. The criteria for assessing the nature of injury are clearly spelled out in the agreement. However, if a country decides to exercise its option to safeguard its imports, this action has to be reciprocal. As a general principle, the exporting country can seek compensation through consultation, otherwise the exporting country can take an equivalent retaliatory action.

Implementation of Safeguard Measures: The safeguard measures are being used more frequently in recent years by the WTO members as compared to earlier period. The WTO Secretariat has been formally notified that 85 safeguard investigations have been initiated since 1999 of which definitive safeguard measures have been only 41. Regarding Pakistani products, only combed cotton yarn has been affected by measures initiated by USA. Nonetheless, this action was found illegal by the authorized body on the ground that it was not consonant with the Agreement on Textile and Clothing. However, by the time the decision was communicated, the period of action had already lapsed.

Enactment and Application of Law in Pakistan: In response to WTO Safeguards Measures Agreement, Pakistan has promulgated Safeguard Ordinance, 2002 to deal with any significant injury or threat of injury due to abrupt rise in the volume of imports. Like anti-dumping and countervailing duties, NTC has also been entrusted with the enforcement and administration of the agreement on safeguard measures.

Concluding Observations

Pakistan's compliance to various agreements related to market access has been fairly significant. But optimal benefits of unilateral submission to these agreements have not materialized for the simple reason that while the developed countries are demanding unrestricted access to markets in the developing world, the same has been denied by them. Agricultural subsidies and slower than anticipated phasing out of the textile quota restrictions are the major stumbling blocks for the success of the WTO Agreements on market access. The failure of the recent round of Ministerial Conference at Cancun is a clear manifestation of this concern.

On the issue of application of trade defense measures it appears that one of the reasons for its misuse is the absence of established criteria to initiate cases against the 'alleged' violators. It has been observed that initially the developed world and now India and Argentina have started to extensively use the option of trade defense measure to deny market access to exporting countries. In contrast, very few cases have been initiated and investigated in Pakistan. One reason could be that it is difficult to prove material injury to the domestic industry, especially when foreign currencies are appreciating and there is incomplete pass-through of exchange rate. There is likelihood though, that the pace of such cases may increase with passage of time. Indeed, looking at India's recent rapid pace, there are already some concerns among the block of developed countries giving rise to initial talk about the need to curb this outlet.

IV

WTO Agreement on Customs Valuation: Pakistan's Experience in Historical Perspective²¹

Price is what you pay. Value is what you get.

Background

In this world everything has value but its precise nature is often unknown. Customs valuation is the procedure used by customs officials to determine the value of the imported goods for the purposes of calculating the right amount of import duty. This is a delicate issue as an incorrect valuation means importers are undercharged for duty. This in turn causes loss to the national exchequer and also creates unfair competition for the local manufacturers in the market. On the other hand, if importers especially investors are unsure how the value will be calculated, the business of importing goods for investment becomes unpredictable. Poor Customs valuation procedures defies protection to the local industry and can act as a deterrent for bona fide traders, since importers need to be sure how much duty their goods will attract in order to decide whether or not a profit could be made by importing goods. Thus, the need for accurate assessment of imported goods is crucial from various angles. The purpose of the present study is to analyse Pakistan's experience with respect to adoption of customs valuation agreements in historical perspective. The difficulties in the implementation of these agreements are discussed and certain corrective measures are suggested.

Brussels Definition of Value, 1953

The need for a uniform valuation method was felt soon after the end of the 2nd world war so that the trading partners could apply same valuation method to avoid confusion and misunderstandings

²¹ *Author:* Mr. Irfan-ur-Rehman Khan, Second Secretary, Customs Valuation, CBR.

between them. As a result, the 'Brussels Definition of Value' (BDV) was adopted on 28 July 1953.²² This international convention on valuation procedure agreed by majority of countries was based on notional concept of value. The price of the goods was considered as the price the goods would fetch in the open market independent of the buyer or seller.

GATT Valuation Agreement, 1989

Despite the designed uniformity of valuation in the BDV system, it was no more than a notional concept devoid of reality and actual transaction value between the buyer and seller. The arbitrary system of valuation was, thus, considered a non-tariff barrier (NTB), which required improvement. In an effort to introduce positive valuation system, the Agreement on Implementation of Article VII of the GATT was adopted in 1979 and entered into force on 1st January 1989. Its aim was to establish a fair, uniform and neutral system for the valuation of goods for levying of customs duty, conforming to commercial realities and outlawing the use of arbitrary or fictitious customs value.

WTO Valuation Agreement, 1995

The Agreement was further amended during the Uruguay Round of multilateral trade negotiations. In 1995, the WTO adopted the Article VII of the GATT, which is now called the WTO Agreement on Customs Valuation. Over 145 countries have adopted the new valuation convention for calculation of customs duty on goods. The valuation code states that the value of goods shall be the transactional value, that is, the price paid or payable for the goods sold for export. However, if the declared customs value is in doubt, the Customs administrations have the right to request further information to determine the accuracy of the declared value of the

²² The Definition was embodied in the Convention on the Valuation for Goods for Customs Purposes on December 15, 1950. For further details, see 'Customs Valuation Considerations' by World Customs Organization.

goods. If doubt continues, the agreement provides the customs officials with a number of options, to be applied sequentially, to ensure the declared customs value is correct or reasonably correct. The sequential options are:

- (a) *Transaction value of identical goods*: The value of identical goods can be used to ascertain the transaction value if the goods are the same in all respects. This includes physical characteristics, quality and reputation, production in the same country as the goods being valued and production by the producer of the same goods being valued. If these conditions are met, slight differences in appearance of goods do not necessarily disqualify the goods being used in a comparison to calculate the transaction value.
- (b) *Transaction value of similar goods*: Customs officials can also use the transaction value of similar goods when the transaction value of imported goods is in doubt. Customs officials have recourse to this option if the similar goods:
 - Closely resemble the goods being valued in terms of component materials and characteristics;
 - Are capable of performing the same functions;
 - Are commercially interchangeable with the goods being valued; and are being sold to the same country of importation as the goods being valued.
- (c) *Deduction value*: When the doubt continues even when the above two options have been exercised, the customs value can be determined on the basis of the unit price at which the imported goods (or identical or similar goods) are sold to an unrelated buyer in the greatest aggregate quantity in the country of importation. The greatest number of units sold at one price represents the greatest aggregate quantity. To determine the greatest aggregate quantity, all sales at a given price are taken together and the sum of all the units of goods sold at the price compared with the sum of all the units of goods sold at any other

price. Because this method entails using the sale price of imported goods, deductions are necessary to reduce the price to the appropriate customs value. Examples of deductions that must be made include commission, the sum of profits and general expenses added in connection with sales, transport costs and corresponding insurance costs.

(d) *Computed value*: Computed value determines customs value on the basis of the cost of production of the goods being valued, plus an amount for the profit and general expenses usually reflected in sales from the country of exportation to the country of importation of goods of the same class or kind. Computed value is the sum total of production costs plus profit, general and other expenses.

(e) *Fallback method*: Even after going through the previous options the doubt about the correct customs value still persists, customs value may be determined using reasonable means on the basis of data available in the country of importation. The reasonable means must be consistent with the principles and general provisions of Article VII of GATT. Some methods of calculation are determined not to be 'reasonable means' under the agreement and are prohibited. They include:

- The sale price of goods made in the country of importation;
- A system that provides for customs purposes the higher of two alternative values;
- The price of goods in the domestic market of the country of exportation
- The cost of production (other than the computed values determined for the identical or similar goods),
- The price of goods for the export to a country other than the country of importation,
- Minimum customs values and arbitrary or fictitious values.

It is important to note that neither the importer nor the customs administration is entitled to select the valuation method. As

indicated, the order set out above is binding. However, the exception to the rule is where the Agreement states that the importer may request that the order in which the deductive method and the computed value are applied be reversed.

Benefits of a Well Functioning Valuation System

The WTO Agreement is intended to provide a single system that is fair, uniform and neutral for the valuation of imported goods for customs purposes, conforming to commercial realities and outlawing the use of arbitrary or fictitious customs values. The Agreement, by its positive concept of value, recognizes that customs valuation should, as far as possible, be based on the actual price of the goods to be valued. The uniform, predictable and transparent application of customs valuation facilitates international trade. In determining customs value the WTO Valuation Agreement is the sole valuation system for worldwide application. The Agreement adopts a positive approach by providing a direct link between the collection of duties and commercial reality. The Agreement is also neutral, it is easy to apply where there is a price actually paid or payable, which is the case for most transactions, and the precision and clarity of the Agreement help minimize disputes between traders and customs administrations, thus expediting cargo clearance operations. However, since the valuation code is dependent on post clearance audit, it is more effective in countries where a larger part of the economy is documented and the audit procedures are effectively placed.

Adoption of the New System by Pakistan

Before embarking on the new system, the customs valuation of imported goods in Pakistan was carried out on the basis of the Import Trade Price (ITP) under BDV. ITP manuals were updated at regular intervals and used extensively. Pakistan continued to follow the BDV system of valuation until 1995. Even though the new system under WTO was adopted by a majority of the member

nations in 1995, Pakistan postponed its implement until January 2000 by availing the concession in the Agreement for developing countries. On 1st January 2000 Pakistan implemented the new GATT CODE of Valuation. Under this new valuation code, the price paid or payable subject to certain additions was taken as the transactional value for duty purposes. The earlier system of Import Trade Price manual, a catalogue of minimum values fixed for frequently imported goods used to ensure minimum assessable values, was discarded. Accordingly, the legislative changes were brought into the Customs Act, 1969 in Sections 25 and 30 through Finance Bill, 1999.

Apprehensions and Excitement: Soon after the implementation of the new system, there was a sense of euphoria among the importers that the practice of enhancing the value as per the ITP manual will come to an end and they will be able to get their goods cleared on whatever the value they declare on the invoice. On the other hand, the customs staff was apprehensive and fearful that the new change would result in huge shortfall in revenue collection due to two reasons:

1. The collection of customs duties and sales tax takes place at different customs collectorates, some of which are located in remote areas having limited support facilities and proper means of communication. Compared to this, majority of the importers operate from major cities; and
2. The adoption of new concept of transactions value might increase the incidence of incorrect declaration taking benefit of the switchover to new system and resultantly there is loss to the government exchequer.

In an effort to overcome this problem of incorrect declaration of import value, the customs department prepared a comprehensive catalogue of values of frequently imported goods, the valuation database (VDB) consisting of 27000 items, to serve as basis to

compare goods value declared by the importers. This was an intelligent move by the customs to utilize the same data that was available in the abandoned ITP for VDB database. However, the trade bodies agitated on the VDB being followed like a holy script by the customs field offices despite the fact that it was used only for reference purposes. The CBR later on withdrew it. The statistics show that this change resulted in an insignificant shortfall in revenue collection for the reason that the customs department was already accepting the invoice values of major volume of imports by multinationals.

Implementation Issues and Corrective Measures

The implementation of the WTO Agreement in Pakistan has not been smooth entirely. The difficulties are faced in a number of areas such as the inability to conduct post importation audit due to inadequate record keeping by small scale importers, tackling the menaces of under-invoicing and commercial fraud, development of an effective mechanism against trade defense measures, preparation of the reference value guide, and fixation of minimum value etcetera. Since these issues are critical in nature and require corrective measures, a brief discussion is warranted.

Risk-based Audit Management: The customs valuation is designed as an audit based system. Traditionally the customs documentary checking and physical examination connected with importations and exportations used to take place before the goods were released. For audits to be meaningful and time bound, the two approaches to customs audit usually followed were: the single bill of entry audit approach and the importer wise audit approach. In the former approach, each bill of entry is audited individually irrespective of the importer and in the latter approach, all imports of an importer during a period-usually a year, is taken as a whole and all transactions regardless of the variety of imported goods are taken in totality. Such audits are conducted at importers premises and all

financial statements of the importer's business are taken into consideration for audit. A risk profiling of importers under various risk-based parameters proves to be a better audit management approach in this respect.

The concept of post clearance audit (PCA) allows for speedier clearance of the goods with the audit being performed subsequently at the importer's premises. The philosophy behind the concept of acceptance of price paid or payable for the goods lies in the post clearance Customs audit of importers records to verify that the price paid or payable is also supported by documentary evidences. The main purpose of audit is to ensure that there is no indirect payment or any unaccounted payments made to the seller on account of the goods imported. The audit also ensures that the importer is not providing any free services or raw materials to the foreign seller for the manufacturing of goods subsequently bought from the sellers. For meaningful audit the availability of properly maintained records of imports has to be ensured.

PCA is a new and important area for Pakistan Customs. It is yet to be fully functional as the valuation department, which has been given this task to audit, initially had a shortage of skilled customs auditors. However, through extensive training programs and practical experience gained through audits, the customs department has developed an adequate resource base of experienced auditors. Nonetheless, despite this strength, the successful implementation of PCA in Pakistan requires effective enforcement and provision of trade facilitating measures and simplified procedures in cargo processing and valuation. To ensure maximum revenue yield, full compliance with import/ export regulations and minimum interference/ cost to legitimate trade are also primary considerations.

As far as record keeping for PCA is concerned, the experience has shown that there is no problem of record maintenance in the case of

large enterprises, multinationals and local industries. However, in the case of small and medium enterprises, there is a general reluctance to this requirement. This is not a positive signal, as the whole system may collapse if the record-keeping requirement is not ensured and the resistance continues in the foreseeable future.

The Problems of Under Invoicing and Commercial Fraud: Under-invoicing it is a method of evading customs duties and taxes by declaring the value on the invoice less than the actual value. This happens when the importer colludes with the foreign supplier and makes an understated invoice where as the supplier gets the remaining amount through informal channels such as *hundi*. The second case scenario is where the importer prepares forged or fake invoice, which shows less than actual value. This fake invoice without the knowledge of foreign suppliers is submitted to customs department for calculation of customs duties and taxes. Interestingly, the WTO Agreement has no mechanism to check fake invoicing except through PCA. In a way, the WTO Agreement only deals with bona fide trade and ignores the reality of rampant fake invoicing that is practiced throughout the world, including Pakistan. The Agreement has a weak mechanism to reject the understated value through manipulated invoices at the clearance stage. Similarly, the mechanism is insufficient to check cases where there is group under-invoicing. In such situations there are no evidences of higher values available to doubt the declared value.

As a remedial measure, the Pakistan Customs has attempted to bring more openness to the procedure of assessment. The details of goods arrived and their assessed values previously cleared are now available on CBR website. The customs department has started to exercise the option of taking over goods from importers if someone else offers higher value than the declared value to the customs. These attempts to bring about transparency in the assessment of goods have, to some extent, discouraged under-invoicing. It may,

however, be pointed out the above mentioned system is not part of the WTO Agreement but an indigenously developed procedure which has been further streamlined to make it more practical.

Non-supportive Role of Small Traders: The importance of the agreement lies in the fact that it realized the significance of actual import price being negotiated at a given period of time between the buyer and the seller. The Agreement accommodates the bargain that takes place between the two parties and accepts the actual agreed price depending on the trade dynamics in that continuum of time. Even though the commercial importers operating in Pakistan welcomed the WTO agreement rather warmly, the same has not been true in the case of local manufacturers who had strong reservations on the ground that they have to compete in the local market that is flooded with imported goods. Despite being a logical claim, this contention has no basis as the new system envisages competitive environment for everyone to operate. The Agreement does have provisions to protect domestic industry if it is hurt by non-competitive behavior of exporting countries, which means that rather than non-compliance with the requirements of the new system, the matter can be resolved amicably if raised at the appropriate forum.

The occasional discrepancy in valuation of identical goods cleared from north and south cities of Pakistan traders has been another area of concern for traders. According to them, there have been instances where identical goods cleared from Karachi were assessed at a value different than at Lahore. In view of the seriousness of this concern, CBR has already taken necessary corrective measures to ensure uniformity of assessment throughout the country through better coordination among various customs collectorates. As a result, claims of discrepancy have dwindled significantly in the recent past.

The Issue of Dumping: The WTO anti-dumping agreement allows governments to act against dumping where there is genuine injury to the competing domestic industry. In order to do that the government has to prove that dumping is taking place, calculate the extent of dumping, and show that the dumping is causing injury or threatening to do so. Extra import duty can be charged on a particular product from a particular exporting country in order to bring its price closer to the 'normal value' or to remove the injury to domestic industry in the importing country.

Since anti-dumping measures often invite undue publicity and may also strain relationships between countries, the best course of action to avoid unpleasant situation is to use valuation as an invisible measure. However, special expertise, especially in the areas of customs valuation and PCA, is required for this to be used an effective tool. The customs department can attempt to create the necessary level of protection to the local industry through proper and fair valuation of goods without disturbing the tariff structure.

Reference Value guide: Reference values are listed values of frequently imported goods based on historical import data and market surveys. Such list provides a baseline for the assessing officer to judge whether or not the declared value is reasonably fair. If it is decided to have recourse to secondary methods of assessment, the reference values provide a working base value. However, in no way the reference values are taken as fixed import trade prices. There is need for comprehensive compilation of reference value database. Such a value reference guide can be very useful tool for the assessing officers and it will also help in maintaining uniformity of assessment at all customs stations.

Minimum Values: Under the provisions of WTO Agreement on Valuation developing countries can apply to WTO for maintaining for certain period minimum values for certain imported items which

may hurt the local industry. This is legal recourse to check under invoicing and protection of local industry. Recently the WTO allowed Sri Lanka to maintain minimum values for second hand vehicles. Pakistan has applied to WTO for this facility for several items however; the request has not been accepted by WTO so far.

Concluding Remarks

Notwithstanding the fact that Pakistan has been an active partner in establishing a free trade regime in the world as envisaged in the WTO Agreement, but like other developing countries its ability to implement each and every article of the Agreement in letter and spirit is restricted by a number of factors. Pakistan has already taken numerous innovative steps to deal with situations that are exclusively related to it, however, there are other areas where a lot more is desired. Among them, the effective implementation of post clearance audit is the most essential step. Just as the importance of audit cannot be denied when the taxation system is operating on self-assessment basis, post clearance audit also assumes the central position for the success of customs valuation. Thus, the cooperation of the taxpayers in maintaining records of their business activities is an essential ingredient of the system. Further steps are therefore needed to persuade stakeholders to abide by this prerequisite of the Agreement. Similarly, issues like fixing minimum value and preparation of reference guide also require further attention to mitigate friction between taxpayers and tax administrators.

V

CBR Reform Program: Introducing ‘Income Tax Assistant’²³

Background

To facilitate voluntary compliance, taxpayers need to exhibit general consent to pay taxes, whereas tax administrators need to increase the efficiency of compliance procedures and the effectiveness of taxpayer services. Responding to both of these ‘needs’, the CBR reform plan places considerable emphasis on the importance of effective taxpayer education and facilitation strategies to encourage compliance with the tax laws. This new approach promotes the concept of customer-oriented services to correct the adversarial relationship between taxpayers and tax collectors. It also aims at lowering taxpayers’ compliance costs. The drivers for taxpayers to be compliant are twofold. Firstly, through compliance, which envisages that:

- The tax burden is predictable;
- The tax burden is calculable and with penalties;
- There are minimal intrusions by tax officials;
- There is no need for “negotiated” tax liability;
- There is no fear of retribution;
- There is better control & knowledge of financial status of the business.

Secondly, the repercussions of non-compliance are as follows:

- A fear of being caught;
- More intrusions by tax officials;
- More investigation;
- Assessments for undeclared tax with additional costs in the form of interest, penalties and shame.

Central to the tax education and facilitation function is a strong and well coordinated communications program which offers incentives

²³ *Author:* Mr. Habib Fakhruddin, Member, Taxpayer Education and Facilitation, CBR.

for greater compliance, and develops a customer oriented, user friendly supportive interface between tax administrators and the taxpayers. The successful development of such a function requires a significant cultural change as tax collectors move from a ‘confrontational’ mode to one of taxpayer service, assistance and facilitation.

To facilitate this cultural shift, the Taxpayer Education and Facilitation Function is in the process of introducing new organizational structures, tasks and methods. A key objective is to promote tax facilitation through the promotion of self-assessment of tax liability. Self-assessment fixes the responsibility for declaring tax liability on taxpayers thus freeing the resources to concentrate on non-compliant taxpayers and non-registered traders representing larger amounts of potential tax loss and unfair competition to compliant taxpayers. Self-assessment also minimizes the opportunities of interface with taxpayers and thus reducing the number of negotiated settlements.

The recent endeavor in this respect is the development of extensive literature on taxpayers’ education and facilitation and a software to prepare income tax return, known as the Income Tax Assistant.^{24,25} The main features of this software are as follows.

About the Income Tax Assistant

‘Income Tax Assistant’ software is to assist taxpayers (individuals and association of persons) in preparing their return of income statement of final taxation, wealth statement and allied computation and details for the tax year 2003 in accordance with the provisions of Income Tax Ordinance, 2001. This software can be used for

²⁴ The relevant literature is available on CBR Website: www.cbr.gov.pk.

²⁵ While the beta version of the software prepared in collaboration with PRAL was released during the last week of August 2003, the final version was released on September 11, 2003.

multiple taxpayers and maintains the record of each taxpayer separately.

Objectives: Income Tax assistant has been developed with the following objectives:

- To assist and educate the taxpayers in preparation of their Income Tax Return, Statements and allied computations etc.
- To eliminate human error/discretion and thereby ensuring accuracy.
- To enhance voluntary compliance by reducing the compliance cost and freeing the taxpayer from understanding the technical language of income tax law, procedures and practices.
- To standardize the process

Ease & Benefits: The complexity of the tax laws to cater for current pace of economic developments and the way commercial and non-commercial transactions are affected cannot be avoided. However, in this application a systematic flow using multiple submenu levels has been adopted to overcome the rigor of complexities and to make the preparation of income tax returns etc. simple and user friendly.

Diversity: Income Tax Assistant is not a tax calculator alone. It is an extensive application based on artificial intelligence and covers the following:

- Determination and computation of chargeable income under the following heads:
 - (i) Income from salary
 - (ii) Income from property
 - (iii) Income from business, including preparation of manufacturing, trading and profit and loss account, bifurcation of business income attributable to

receipts/sales etc. subject to final taxation, admissible depreciation, initial allowance and amortization etc.

- (iv) Income from capital gains
- (v) Income from other sources, including those subject to final taxation
- (vi) Foreign source income
- Sources of income exempt from tax
- Exclusions from income
- Determination and computation of gross tax, applicable tax reductions and tax credits for donations, investments, annuity, profit on debt etc.
- Advance income tax
- Additional tax
- Adjustment of prior years refunds
- Wealth Statement/Annual personal expenditure/Reconciliation of wealth.
- Finally, the view and prints of Income Tax Return, Statement of Final Taxation, Wealth Statement and a host of related reports including the Application for Refund of Tax.

Limitations: This software has a limited application and may not cater for complex and unique tax situations peculiar to any specific taxpayer. Especially it does not cover tax situations involving more than one business, brought forward business losses or unabsorbed depreciation and calculation of additional tax.

Availability: Taxpayers can have a complimentary copy of the 'Income Tax Assistant' by submitting the registration form to the Office of Member (TPE&F) personally or through fax [(051)-921-9215] or by e-mail [membertpef@cbr.gov.pk]. Any clarification or guidance in this regard can also be obtained on telephone [(051)-920-3399].

[Your comments and suggestions will help us to achieve our objectives]