

FBR **Quarterly** **Review**

Vol. 10, No. 3, January - March 2010

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



FEDERAL BOARD OF REVENUE

Government of Pakistan

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May: 2010

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Abbreviations

AoPs	Association of Persons
CD	Customs Duties
CFY	Current Fiscal Year
CH	Chapter
CoD	Collection on Demand
DT	Direct Taxes
FBR	Federal Board of Revenue
FED	Federal Excise Duties
FY	Fiscal Year
GST	General Sales Tax
LTU	Large Tax Payers' Unit
MCC	Model Customs Collectorate
NTN	National Tax Number
PCT	Pakistan Customs Tariff
PFY	Previous Fiscal Year
Q3CFY	Quarter 3 Current Fiscal Year
Q3PFY	Quarter 3 Previous Fiscal Year
RTO	Regional Tax Office
ST(D)	Sales Tax Domestic
ST(M)	Sales Tax Import
STARR	Sales Tax Automated Refund Repository
USAS	Universal Self-Assessment Scheme
WTO	World Trade Organization
VAT	Value Added Tax
VP	Voluntary Payments
WHT	Withholding Taxes

Foreword

The latest issue of the FBR Quarterly Review providing information on fiscal matters is being released. The analysis of the revenue data for the July-March 2009-10 provides in-depth analyses of federal taxes that rely on the performance of various segments of the economy, including industrial production, changing consumption habits, and commercial and trade activities. It also gives insight on the contribution of the corporate sector in revenue receipts.

The current issue of the FBR Quarterly Review also includes an article on “Tariff and Trade in Pakistan- A Preliminary Assessment”. The article provides analysis of tariff rationalization and trade openness in Pakistan in historical perspective and explains its cost and benefits.

I appreciate the relentless efforts put in by the Research Team of Strategic Planning, Research & Statistics Wing, FBR in bringing out the publication and hope that contents of the Review will be useful for the readers. We look forward to receiving your valuable comments and suggestions for improving this research effort.

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Secretary Revenue Division/
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May, 2010

I

FBR Tax Collection: An Analysis of the Q3: 09-10 Outturn

The Economy

Notwithstanding, adverse internal and external environment, Pakistan has successfully accomplished the objective of macroeconomic stabilization during the first three quarter of CFY. The recent betterment of prospects for growth outlook of some of the industrialized countries and emerging markets, the outlook for economic growth improved as demand for imports and prospects for exports revived, tax collection improved, and current account deficit shrank. The Economic Stabilization Program has already ensured substantial adjustment in non-productive subsidies to reduce the burden on the budget and the government is following fiscal deficit reverently. However, pressures on domestic demand are escalating from fiscal deficit side. It is expected that real GDP to grow by 4.1 percent in 2009-10. The major impetus to this modest recovery is likely to come from strong domestic consumption demand as manifested in stellar growth in production of consumer durables. Activity in the Large-scale manufacturing (LSM) depicted strong revival amidst continuing energy shortages and rising cost of production owing to spike in prices of imported inputs and electricity during the last few months. Better than expected performance of the manufacturing, revival in the construction sector and healthy performance by the services sector are likely to support a modest revival in growth during 2009-10.

Another mark improvement has been witnessed in the crucial area of inflation. The inflation rate as measured by the changes in Consumer Price Index (CPI) stood at 11.3 percent in the first nine months of the current fiscal year (2009-10) as against 23.0 percent in the comparable period of last year. However, year-on-year inflation has decelerated

from 22.1 percent in March 2009 to 12.1 percent in March 2010. Food inflation is estimated at 11.7 percent and non-food 10.9 percent against 27.8 percent and 19.2 percent respectively last year. Sugar, milk and meat prices continue to remain the stronger contributors to food as well as overall inflation during the period (July-March 2009-10). Wheat, on the other hand, remained supportive to keep food inflation down. In the non-food inflation, energy and transport & communication have been the major drivers. Moreover, deceleration has also been witnessed in core inflation which represents the rate of increase in cost of goods and services excluding food and energy prices also decelerated to 11.2 percent in July-March 2009-10 from 17.9 percent in the comparable period of last year.

However, domestic environment is still affected by the intensification of war on terror and volatile security situation while external environment is affected by uncertainties surrounding external inflows and oil prices. Notwithstanding substantial improvement in the current account deficit, the external sector vulnerabilities needs a review ,especially, in the backdrop of spike in international crude oil prices which bounced back from as low as \$33 per barrel in January 2009 to beyond \$85 in May 2010. Despite support from the IMF and other bilateral and multilateral donors, recent trends in most macroeconomic variables suggest that the implementation of macroeconomic stabilization program has provided credibility to the economic policies. The narrowing of the trade deficit and robust remittances has caused a reduction of almost \$2 billion in the current account deficit 2008-09 and further improvement of over \$3 billion is estimated in 2009-10 which allowed for a build-up of the country's foreign exchange reserves beyond \$16 billion from as low as \$6.4 billion in October 2008.

Pakistan economy still faces pressures from higher inflation driven mainly by spike in food prices, acute power shortages, amidst rising security related expenditure, thereby, putting pressure on fiscal deficit;

lower than anticipated inflows and growing absolute financing requirements. Abatement of inflationary pressure remained oblivious and prices depicted stubbornness.

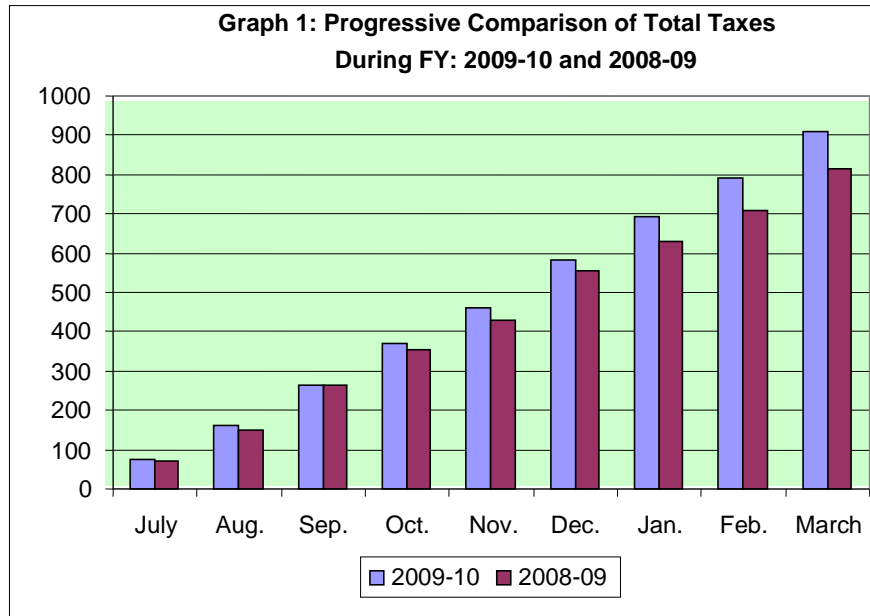
FBR Revenue Collection Vis-à-vis Target

FBR has been able to achieve double digit growth of 11.6% in the tax receipts as compared to previous year (Table 1). Moreover, sales tax and direct taxes grew by 15.6% and 11.3% respectively during July-March, 2009-10. On the other hand, federal excise exhibited only 4.2% growth in the collection mainly due to transfer of insurance and banking services to sales tax and withdrawal of FED from motor vehicles. The collection of customs duty grew by 6% despite decline of 3.7% in the dutiable import during first three quarters of CFY. Federal taxes in gross and net terms, Rs. 966 billion and Rs. 906.6 billion have been collected respectively during July-March, 2009-10. The gross and net collections grew by 10.9% and 11.6% during July-March 2009-10 as compared to the corresponding period last year.

Table 1: Net Revenue Receipts during July-March, 2009-10
(Rs. Billion)

Tax Heads	Tax Collection		Growth (%)
	2009-10	2008-09	
Direct taxes	342.3	307.6	11.3
Sales Tax	371.2	321.1	15.6
Federal Excise	84.4	81.0	4.2
Customs Duty	111.7	105.4	6.0
Total	909.6	815.1	11.6

Graph 1 reflects that month wise collection of FBR that from July to September 2009 has marginally crossed the last year's collection. But since October, 2009 there has been great momentum in revenue collection, which reflects that the growth pattern will continue in the last quarter of CFY and the assigned target is likely to be achieved.



The target fixed for federal taxes for July-March, 2009-10 has been achieved to the extent of 96.9%. This achievement is significant when viewed in the context of overall economic situation, low growth in imports and decline in dutiable imports, and large scale load shedding. More importantly, in August 2009, the rate of GST on sugar has been slashed by 50%, which has adversely impacted the revenue collection. Similarly, the government has also slashed down the size of PSDP by almost 50%, resultantly, collection under WHT on contracts and supplies has badly affected. It may also be highlighted that at the time of fixation of budget 2009-10, the CVT was estimated to generate Rs. 15 billion on account of increasing the rate from 2% to 4%, on the contrary this measure did not materialize to a great extent. Had these measures not been taken, FBR would have achieved the assigned target fixed for the period under review. However, FBR is making all out efforts to bridge this gap through better administration and reach the target of Rs. 1380 billion at the end of the year. Tax-wise targets and their achievements have been highlighted in Table 2.

Table 2: Targets and Net Revenue Receipts: A Comparison
(Rs. Billion)

Taxes	FY 09-10		Achievement (%)
	Target	Collection	
Direct taxes	356.0	342.3	96.2
Sales Tax	380.4	371.2	97.6
Federal Excise	87.6	84.4	96.4
Customs Duty	114.7	111.7	97.4
Total	938.7	909.6	96.9

The tax-wise details reveal that shortfall in the collection viz a viz target has occurred in all the taxes. In case of direct taxes, the date of payment for advance tax was changed in the Budget 2009-10 from 15th of the last month of the quarter in PFY to the 15th of the following month of the quarter in CFY. This measure has been mainly responsible for decline in the collection of direct taxes. Similarly, banking and insurance services were shifted from FED to sales tax while FED was withdrawn from motor cars. On the other hand, the low growth in imports and decline in the dutiable imports have also affected the collection of customs and sales tax imports to a great extent.

Detailed Analysis of Individual Taxes

Direct Taxes: Gross and net collection of direct taxes during July-March, 2009-10 has been Rs. 378.9 billion and Rs. 342.3 billion reflecting growths of 12.4% and 11.3% respectively. This performance is commendable in the face of the following adverse factors impeded in the growth of collection of direct taxes during July-March, 2009-10:

- a) As indicated earlier, change of payment of advance tax date from 15th of last month of the quarter to the 15th of the following month of the quarter.
- b) Moreover, the amount of PSDP has been slashed down by almost 50% which has adversely impacted the revenue collection under WHT on contracts and domestic supplies.

Analysis of Components of Direct Taxes

There are three components of direct taxes i.e. individual income tax, corporate tax and other direct taxes. The distribution of the collection is categorized into following heads:

- a) Collection on Demand (COD)
- b) Voluntary Payments (VP) in the shape of tax with returns, advance tax and
- c) Withholding taxes (WHT).
- d) The other direct taxes include CVT, WWF and WPPF which account for less than 4 percent of gross collection.

Table 3 highlights the performance of each of these heads during CFY as compared to the previous year.

Table 3: Direct Taxes Collection July-March

(Rs. Million)

Revenue Heads	2009-10	2008-09	Growth (%)
Coll. On Demand	60,066	49,056	22.4
Arrear	17,355	12,166	42.7
Current	42,711	36,890	15.8
Voluntary payment	100,516	106,673	-5.8
With Returns	8,808	14,319	-38.5
Advance Tax	91,707	92,354	-0.7
Withholding Taxes	205,692	169,167	21.6
Misc	92	242	-62.0
Total I. Tax (Gross)	366,274	324,896	12.7
Refund	36,544	29,477	24.0
Income Tax (Net)	329,822	295,662	11.6
Other Direct Taxes	12,525	11,918	5.1
Direct Tax(Net)	342,347	307,580	11.3

Voluntary Payments (VP)

The collection from voluntary compliance has reflected a decline of 5.8% during July-March 2009-10 as compared to the PFY. Major component of voluntary compliance is advance tax. The change of dates of payments as discussed above has vastly affected its collection of advance tax during July-March, 2009-10. On the other hand, robust decline of around 39% in the payments with returns has also affected the overall collection of payments with returns. The situation requires intensive audit operations in this regard.

Collection on Demand (COD)

The collection on demand is an area which reflects the efforts of the department in safeguarding the government revenues. The collection on demand has improved from Rs. 49.1 billion in July-March, 2008-09 to Rs. 60.1 billion during 2009-10 indicating a growth of 22.4%. Both the components of collection of demand i.e. arrear demand and current demand have improved substantially and reflective of the better efforts of the department. In fact, the component of arrear demand has increased by 42.7% while the collection from current demand grew by 15.8%

It was natural to presume that with the introduction of USAS in the income tax, voluntary compliance will surge and, on the contrary, the collection on demand will come down. This presumption has been true for the initial few years, but in the later years, the situation started changing and now there are reverse trends in this regard. It is reiterated that if USAS is not backed with an effective audit mechanism, it may not yield the desired results.

Withholding Taxes (WHT)

Withholding taxes contributes 3/5th of the direct tax collection and grew by around 22%. In fact, the WHT collection during July-March 2009-10 has been Rs. 205.7 billion against Rs. 169.2 billion during PFY. The top ten major withholding taxes constituting 92% of total WHT collection is the same as in the previous year. The major

withholding taxes have generated bulk of the revenues are: contracts, imports, salary, telephone, export, bank interest, electricity, dividends and cash withdrawal (Table 4).

Contracts have been the top revenue generating source of withholding taxes. The collection from contracts has exhibited a double growth of around 12% during July-March, 2009-10 despite reduced PSDP. On the other hand, the collections of WHT from imports have gone up strongly by 62% despite a low growth in the import value. This is understandable that the rate of withholding tax on imports has been revised upward from 2% to 4%.

As far as the collection from salaries is concerned, it grew by around 20%. It might be partially due to raise in the pays of the government servants. Similarly, growth of 25% growth in the collection from electricity is concerned; upward revision of electricity tariff is attributable to this increase. The collection from telephones grew by 9% during July-March, 2009-10 while the remaining major spinners of withholding taxes exhibited double digit growths.

Table 4: A Comparison of FY 09-10 & FY 08-09 Collection

(Rs. Million)

Collection Head	2009-10	2008-09	Difference	
			Absolute	Percent
Contracts	64,214	57,332	6,882	12.0
Imports	35,351	21,827	13,524	62.0
Salary	22,195	18,528	3,667	19.8
Electricity	10,602	8,479	2,123	25.0
Telephone	16,783	15,403	1,380	9.0
Export	11,920	10,568	1,352	12.8
Dividends	5,279	4,743	536	11.3
Cash Withdrawal	9,426	8,129	1,297	16.0
Bank Interest	12,877	10,121	2,756	27.2
Sub Total	188,647	155,130	33,517	21.6
% Share in total WHT	92	92		
Other WHT	17,045	14,037	3,008	21.4
Total WHT	205,692	169,167	36,525	21.6
Share (%) in Gross I. Tax	56	52		

Sales Tax: GST is top revenue generating sources of federal tax receipts. It has contributed 40.8% of the total net revenue collection during the first nine months of FY: 09-10. The gross and net collection has been Rs. 386.4 billion and Rs. 371.2 billion, respectively exhibiting growths of 13.5% and 15.6% over the corresponding period of PFY. The refund payments have declined by Rs. 4 billion or 21.5% during this period. It is evident from Table 5 that the gross and net collection of sales tax has exhibited double digit growths in its both components.

**Table 5: Sales Tax Collection: A Comparison of
FY 09-10 & FY 08-09**

(Rs. Billion)

Description	FY 09-10		FY:08-09		Growth (%)	
	Gross	Net	Gross	Net	Gross	Net
S. Tax (Imports)	172.9	172.9	147.3	147.3	17.4	17.4
S. Tax (Domestic)	213.5	198.3	193.2	173.9	10.5	14.0
July-March	386.4	371.2	340.5	321.1	13.5	15.6

The detail analysis of sales tax imports and sales tax domestic is presented in the followings:

Sales Tax Domestic Collection and Major Revenue Spinners: The details of sector-wise collection of major revenue spinners of sales tax domestic have been highlighted in Table 6. These major items contributed 89.2% of the total net collection from sales tax domestic.

Petroleum products are the main revenue generating source of collection of sales tax domestic. The collection from POL products has increased by 10.8% over last year's collection. A decline of around one billion rupees in the payment of refunds during this period has increased the net collection of petroleum products. After robust contribution by telecommunication in the recent years, the tempo of revenue generation has been disturbed. The collection during July-March, 2009-10 has even come down by 12.3%. This sector was exposed to higher rates of 21% from 2008-09 to 19.5% in 2009-10.

A significant growth of around 19% in the natural gas has been recorded. Major driver of this double digit growth has been the lesser payments of refunds by Rs. 2.5 billion during July-March, 2009-10. These reduced payment of refunds changed the negative growth of gross collection to a considerable positive growth in the net collection.

A massive growth of around 167% in the services other than telecommunication is understandable as two prolific services from FED were shifted to sales tax domestic in the Budget 2009-10. Similarly, the collection from electricity has also gone up by 36.9% due to increased tariff in the current financial year. The negative growth in collection from sugar is partly due to reduced rate of sugar. The significant growth of 12.7% in the collection from cigarettes seems on lower side, especially, if viewed in the context of increased prices of cigarettes and around 19% growth in the collection of FED. The remaining three spinners i.e. beverages, tea and cement have grown their collection by 57.6%, 30.1% and 8.3% respectively.

Table 6: Net Sales Tax (domestic) Collection Ten Major Items
(Rs. Million)

S. No.	Commodity Groups	Collection Up to March 2010	Collection Up to March 2009	Growth (%)
1	POL Products	85,193	76,904	10.8
2	Telecommunication	32,235	36,772	-12.3
3	Natural Gas	15,090	12,703	18.8
4	Services (other than telecom)	11,910	4,457	167.2
5	Sugar	7,282	8,357	-12.9
6	Cigarettes	7,156	6,349	12.7
7	Electrical Energy	7,108	5,193	36.9
8	Beverages/ Aerated water	4,314	2,738	57.6
9	Tea	3,322	2,553	30.1
10	Cement	3,154	2,911	8.3
Sub Total		176,764	158,936	11.2
	Other	21496	14925	44.0
Total		198,261	173,861	14.0

Sales Tax at Import Stage:

Sales tax on import is an important component of total sales tax collection. Currently, sales tax contributes 46.6% of the total sales tax collection. The collection of top ten spinners of sales tax on imports has been presented in Table 7. Out of ten major commodity groups, 8 have exhibited positive growth in the collection. Only two commodities groups reflected negative growth in their collection due to decline in the value of imports.

Like sales tax domestic, petroleum is the top revenue generation source of sales tax imports. It contributes 40% of the collection of sales tax imports. The robust growth of 21.2% in the collection of sales tax on imports from POL products has been mainly due to massive growth in the imports of motor spirit, furnace oil and JP-1. Resultantly, their collection grew by 564%, 44% and 142% respectively. Despite massive growth in some items, overall import of POL products grew at only 4.7% mainly due to decline in the import of HSD oil, a major item. The growth of 9.6% in the collection of plastics is aligned with 11.3% in its import. On the other hand, the collection of edible oils (Ch: 15) has come down marginally due to decline in the value of imports of edible oils. The collection of sales tax from iron and steel (Ch:72) has grown by 22.9% due to 2.9% growth in its imports.

Robust growth of 45.1% in imports of automobile (Ch: 87) has led to 33.7% growth in the collection of sales tax. On the other hand, a major surge in the imports of oilseed has recorded, resultantly, massive growth of 141.1% in the sales tax has been observed.

Table 7: Major Revenue Spinners of Sales Tax at Import Stage*(Rs. Million)*

PCT Chapter	Tariff Description	ST (M) Collection		
		JM: 09-10	JM: 08-09	Growth (%)
27	POL Products	69,462	57,300	21.2
39	Plastic Resins etc	13,445	12,273	9.6
15	Edible oil and Waxes	12,778	12,792	-0.1
72	Iron and Steel	11,631	9,494	22.9
87	Vehicles	10,746	8,035	33.7
84	Mechanical Machinery	5,466	4,958	10.2
29	Organic chemicals	4,819	4,104	17.4
85	Electrical Machinery	4,654	4,320	7.7
12	Oilseeds	4,361	1,809	141.0
48	Paper and Paperboard	3,642	4,058	-10.2
<i>Sub-total</i>		<i>141,004</i>	<i>119,143</i>	<i>18.3</i>
Others		31,893	28,135	13.4
Grand Total		172,897	147,278	17.4

Customs Duties

The gross and net collection of customs duties has been Rs. 116.2 billion and Rs. 111.7 billion respectively during July-March 2009-10 and grew by 3.5% and 6%. The difference between the gross and net collection is due to Rs. 2.3 billion lesser payments of refunds/rebates. The decline in the dutiable imports by 3.7% has mainly been responsible for low growth of collection of customs duties.

The customs receipts have been highly concentrated in few items reflecting vulnerability of its revenues. This phenomenon warrants further diversification as only ten major revenue spinners constitute 64% of the customs duties. Only four items petroleum, automobile, edible oils and machinery contribute around 48% of total CD during July-March, 2009-10. Top ten revenue generating groups of items (PCT Chapters) have been highlighted in Table 8.

Table 8: Growth in Collection of Customs Duties during July-March, 09-10

(Rs Million)

PCT Chapter	Tariff Description	Customs Duties			Share (%)	
		2009-10	2009-08	Growth (%)	2009-10	2009-08
87	Vehicles	16,681	13,274	25.7	14.4	11.8
27	POL product	12,647	15,509	-18.5	10.9	13.8
15	Edible oil and Waxes	11,426	12,151	-6.0	9.8	10.8
84	Mechanical Machinery	7,646	10,069	-24.1	6.6	9.0
85	Electrical Machinery	6,885	10,195	-32.5	5.9	9.1
72	Iron and Steel.	5,558	4,921	12.9	4.8	4.4
39	Plastic	5,074	5,035	0.8	4.4	4.5
48	Paper and Paperboard	3,598	3,547	1.5	3.1	3.2
29	Organic Chemicals	2,839	2,617	8.5	2.4	2.3
9	Coffee, Tea etc	2,005	1,764	13.7	1.7	1.6
<i>Sub-Total</i>		74,359	79,082	-6.0	64.0	70.4
Others		41,880	33,255	25.9	36.0	29.6
Grand Total		116,239	112,337	3.5	100.0	100.0

Unlike previous year, the dutiable import of automobile has gone up substantially by 36.8% during July-March, 2009-10. Its share in the total collection of customs has also improved from 11.8% during July-March 2008-09 to 14.4% in 2009-10. This has improved the collection of customs duty by 25.7% from automobile (CH:87). Major part of customs duty has been contributed by the import of motor cars/jeeps (PCT 87.03). The dutiable import of motorcars/jeeps has increased by 39.5% which has enhanced the collection of customs duties by 25% or Rs.2.3 billion.

In the first four months of the previous fiscal year, the value of imports picked up enormously due to soaring international prices of petroleum and resultantly, robust improvement in the collection of customs duties was recorded. Conversely, extremely low prices of petroleum products during current fiscal year, in the same period, have vastly affected the collection of customs duties. Due to this, the share of petroleum products has come down from 13.8% in July-March 2008-09 to 10.9% of the customs duties in the corresponding period of CFY.

There has been a decline of 9.8% in the value of import of edible oils (Ch:15) and the collection of customs duties has also dropped by 6%. The collection of customs duties has been mainly fetched from the import of palm oils i.e. palm oil, R.B.D palm oil and crude oil.

As far as the machinery is concerned, the import of electrical and mechanical machinery have dropped by 25.8% and 24.3% during July-March, 2009-10 and their collections have also been declined by 32.5% and 24.1% respectively. The dutiable import of iron and steel (CH:72) has gone up by 25.8% and resultantly, the collection from it has also increased by 12.9%. The remaining four items in the major spinners have exhibited growth in the collection of customs duty due to increased dutiable imports.

Federal Excise: Despite limited base, FED is contributing significantly to the national exchequer. During July-March 2009-10, Rs. 84.4 billion have been collected against Rs. 81 billion in the corresponding period of last year, entailing a growth of around 4.2%. This performance is commendable when viewed in the context of shifting of banking and insurance services from FED to FED in VAT mode during 2009-10. Moreover, FED on motor vehicles was also withdrawn in the Budget 2009-10.

Major Revenue Spinners: The six major revenue spinners of FED contributed about 80.7% in FED collection during July-March 2009-10. These major heads are cigarettes, cement, beverages, natural gas, POL Products and services. Details of their collection and contribution in FED have been depicted in Table 9.

Table 9: FED Collection from Major Commodities

(Rs. Million)

Commodities	July-March		Difference		Share (%)	
	09-10	08-09	Absolute	Percent	09-10	08-09
Cigarettes	29,173	24,588	4,585	18.6	34.6	30.4
Cement	11,848	12,844	-996	-7.8	14.0	15.9
Natural Gas	4,616	4,526	90	2.0	5.5	5.6
POL Products	3,364	2,827	537	19.0	4.0	3.5
Beverages	7,180	6,866	314	4.6	8.5	8.5
Services	11,963	12,615	-652	-5.2	14.2	15.6
Sub Total	68,144	64,266	3,878	6.0	80.7	79.3
Others	16,263	16,734	-471	-2.8	19.3	20.7
Grand Total	84,407	81,000	3,407	4.2	100.0	100.0

Out of six major spinners of FED, 4 have exhibited positive growth i.e. POL product (18.6%), cigarettes (18.6%), beverages (4.6%) and natural gas (2%). The higher growth in cigarettes has been mainly due to increased retail prices by upward adjustment in FED rates.

Despite growth of 11.2% in the production of cement during July-March, 2009-10 and increased rates, the collection has come down by 7.8% during July-March, 2009-10. As far as beverages are concerned; the collection of FED has shown 5.2% growth despite 18% decline in the production of beverages. A decline of 5.2% in the services is attributable to the transfer of banking and insurance services from FED to sales tax domestic in the Budget 2009-10.

Concluding Observations

Despite many economic challenges, FBR has been able to achieve a growth of 11.6%. Low prices of petroleum products as compared to the previous year in the first four months have also impeded the growth in the collection of import related taxes. Low growth in the imports in CFY means corresponding low growth in the collection of import related taxes. The target of Rs. 1380 billion was set extremely on higher side and the government has taken certain measures during the year which has negatively impacted the revenue generation process, like reduction of 50% GST on sugar, slashed down the size of PSDP etc. However, despite all odds, FBR is making all out efforts to generate sufficient revenues during the remaining period to reach the target of Rs. 1380 billion at the end of FY: 2009-10.

II

Tariff and Trade in Pakistan- A Preliminary Assessment

By

Mir Ahmad Khan¹

Introduction

Besides raising government revenues, customs duties are generally utilized as vital tool for protecting domestic industries against foreign competition, limiting the consumption of imported luxury and unnecessary goods. The recent experience shows that the reduction of tariff has also played an active role in liberalization of trade and helped in achieving higher degree of openness in the world. The determination of a tariff structure entails a number of socio-economic considerations and international obligations. The revenues from customs duty is directly related to tariff, structure of slabs, inflow of foreign direct investment, rupee to dollar exchange rate, composition of imports and above all, the state of economy. Moreover, salient feature of the customs duties is that it is taken as component while calculating base for other import related taxes. Customs duty is still one of the vital components of federal tax collection contributing 20.7% of the indirect taxes and 12.8% of the total federal taxes. This is despite gradual reduction of maximum customs duty rates and tariff peaks.

In the absence of any meaningful contribution of the domestic sector revenue generation in the past, Pakistan, like other developing countries of the world, relied heavily on international trade taxes especially customs duties. The objective of the premeditated policy was to generate revenues at source and to protect local industries that were at their infancy stage.

This high level of protection in the past has not only generated gross inefficiencies in the system as the quality of goods produced by the

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domestic industry suffered badly but it has also become a major obstacle for growth of the economy. Higher protection to the imports has also generated anti-export bias. Protection makes it more difficult for exporters to compete because of its direct effect on cost of raw materials/intermediate inputs, and its indirect effects on the cost of labour and the exchange rates (Flatters 2001).

Moreover, higher protection encouraged smuggling which is also detrimental for growth of domestic sector. According to Flatters (2001), protection is a subsidy to smugglers, thus, increases in protection, increase the incentive to smuggle.

In order to mitigate these concerns, the introduction of trade reforms during the second half of 80s were initiated to make indigenous industries more competitive, efficient and receptive to face the future trade-related challenges emanating from regional countries and the world at large. Moreover, a downward revision was also necessary to reduce the gap between bound tariff under WTO and applied tariff, and to reduce the incidence of smuggling and higher cost of doing business. This move has also forced the government to focus the revenue generation from the domestic taxes and, to a great extent; the compensation has been made by income tax and GST.

The main purpose of this article is to revisit the structure of tariff and its role in the trade liberalization and volume of revenues. Apart from that, an attempt has been made to analyze the fluctuations in duty free imports and level of cost of exemption of customs duties.

Trade Liberalization in Pakistan

There has been a strong quest for openness of the trade regime in Pakistan but still government was bound to prefer the application of higher rates for revenue generation in the face of low yield from the domestic taxes. The first phase of trade liberalization was started in 1983-84. Main thrust of the liberalization was on non-tariff measures

like gradual reduction of negative list. On the other hand, para tariffs were levied @10% general surcharge, 5% iqra surcharge and 6% licensing fees that time. No revenue loss incurred due to first phase of trade liberalization as effective rate was increased from 38% in 1979/80 to 53% in 1987-88. Unlike first phase, the government launched second phase with main thrust on tariff reduction.

Although Pakistan started to slash down its tariff to a great extent in 1988-89 but has lost the initiatives by delaying the trade openness with strong intensity in the 90s but lead was taken by India and Sri Lanka. According to World Bank² study, during 1990s, most countries in South Asia liberalized their trade policies significantly, while Pakistan postponed broader and deeper tariff rationalization until end of the decade. This was one of the core reasons for slow growth of GDP and low level of openness. Similarly, Dr Ishrat Hussain (2008) has also elucidated that although the contours of reforms were drawn in 1991, the pace of implementation picked up only after 1999. At the start of the 2000s, the tariff reforms were religiously followed and fruits of these reforms were the robust growth of the GDP and Pakistan was among the highest growing economies of the world. Unlike other countries, Pakistan's tariff rationalization reflects low protection to the agriculture sector despite agriculture being the mainstay of the economy of the country.

The gradual reduction of the maximum statutory rate of customs duty presented in Table 1 clearly elucidates how seriously the policy of tariff reforms has been pursued in the country. Not only that the maximum rate of duty has been reduced from 150% in 1987-88 to 25% in 2003-04 raised to 35% in 2008-09 and onwards. Not only general maximum tariff has slashed down significantly, but also standard tariff slabs were also reduced from 14 in 1996-97 to 6 (0, 5%, 10%, 15%, 20%, 25%, 35%) in 2009-10.

²See for more details "World Bank (2006), Pakistan Growth and Export Competitiveness".

With the revision of statutory rates, the effective tariff rate of customs duties relative to dutiable imports declined from 53.6% in FY 1987-88 to 11.1% in FY 08-09. Similarly, the effective rate based on total imports has also declined significantly from 33.8% to 5.4% during this period. As a result, the share of customs duty in federal tax receipts has also come down drastically from 50.1% in FY: 1987-88 to only 12.8% in FY: 08-09.

Table 1: Tariff Structure, Customs Duties, Effective Rates and Trade Openness

YEAR	Max. Tariff Rate (%)	Net Customs Duties (Rs. Million)	Share of CD in FBR Revenue (%)	Effective Rates (%)		Trade Openness %
				Dutiable Imports	Total Import	
1987-88	150	38,001	50.1	53.6	33.8	28.3
1988-89	125	42,362	47.0	48.0	31.2	29.4
1990-91	125 / 95	50,528	45.7	53.7	29.5	30.3
1991-92	90	61,821	44.2	46.4	26.9	33.2
1993-94	80	64,240	37.2	38.3	24.9	29.7
1994-95	70	77,653	34.3	35.7	24.2	30.7
1995-96	65	88,916	33.2	33.2	22.4	32.7
1997-98	45	74,496	25.4	22.0	17.1	30.2
1998-99	40/35	65,292	21.2	18.4	14.0	29.1
1999-00	35	61,659	17.8	17.8	11.6	25.5
2000-01	30	65,047	16.6	16.8	10.4	27.7
2002-03	25	68,836	14.9	15.8	9.6	28.0
2003-04	25	91,045	17.5	14.5	10.1	28.5
2004-05	25	115,374	19.5	13.3	9.4	32.0
2005-06	25	138,384	19.4	13.1	8.1	35.4
2006-07	25	132,299	15.6	13.1	7.1	33.2
2007-08	35	150,663	14.9	11.7	6.0	36.3
2008-09	35	148,403	12.8	11.1	5.4	31.5

Source: Calculation by Author based on data from
i) Pakistan Economic Surveys (various issues)
ii) FBR Data Bank

As far as trade openness in Pakistan is concerned, it was only 28.3% in 1987-88 improved to 31% in 2008-09. In case of India, due to liberalization, the trade openness ratio doubled around 15% in most of the 80s to 27% in 2000s and gone up to 47% in 2006 (Alessandrini, Futtouh, Ferrarini and Scaramozzino 2009). The major reason for low openness in Pakistan as compared to international standard is mainly attributable to the export. Export to GDP ratio during 1987-88 was 11.6% which has come down to only 10.7% in 2008-09. The main reason behind this performance is the lack of diversification as export of Pakistan has been concentrated into few commodities. On the other hand, import to GDP ratio has gone up from 16.7% in 1987-88 to 20.8% in 2008-09. As far as import is concerned, the import openness has increased.

One point which is to be noted that the customs duties receipts have doubled from 1988-89 to 2003-04 and tripled in 2006-07 and improved further with the passage of time. The loss in CD due to large scale tariff rationalization has been compensated by the buoyant GST.

Current Structure of Tariff

Table 2 provides structure of tariff in relation to the slabs and products during 2009-10. Out of 6803 tariff lines, 414 tariff lines are zero rated and applied on primary products. The highest category involving 2328 tariff lines are subject to 5% on other primary and secondary goods while 873 tariff lines are under 10% related to intermediate/secondary raw materials. Above this, higher tariff rates have been applied on remaining tariff lines. The structure is highly escalated. In case of Sri Lanka, customs duty @0-2.5% is applied on input raw materials while 6 or 15% on intermediate goods and 28% on finished or luxury goods (Annual Report 2008, MOF, Sri Lanka).

Table 2: Slab-wise Tariff Lines and Products

Slabs	Tariff Lines	Products
0	414	Primary raw materials, computers, seeds, live bovine animals, fish eggs, bulbs & tubers, trees, petroleum products, chemicals, fertilizers rubber, hides & skins, wood, cotton etc.
5	2,328	Primary /Secondary raw materials/inputs, machinery, chemicals, medicines
10	873	Secondary raw material/intermediate goods, foods preparations etc.
15	471	Mostly locally manufactured raw materials, intermediate goods, inputs etc.
20	871	Mostly semi finished/finished goods
25	1,094	Mostly finished goods
30	76	Non-essential/luxury items, prime movers, tractors less than 280 HP, dumpers, trucks above 5 tones.
35	555	Non-essential/luxury items/ Auto parts and CKD kits of vehicles.
50	13	Cars & Jeeps up to 800cc auto rickshaws
55	6	Cars & Jeeps up to 801 cc to 1000cc.
60	9	Cars & Jeeps up to 1001 cc to 1500 cc, trucks not exceeding 5 tones.
65	13	On motorcycles.
75	4	Cars & Jeeps up to 1501 cc to 1800 cc.
90	16	Alcoholic beverages
100	13	Cars & Jeeps above 1800cc
Composite	2	Cinematic films
Specific	45	Mostly on edible oils plus betel leaves, mobile phone, silver and gold.
TOTAL	6,803	

Source: Customs Wing, FBR³

Simple Average Tariff ⁴

Simple average tariff is a useful measure of degree of protection and is simply the mean of tariff in a country or region tariff schedule as whole

³This table has been prepared by Assad Jawad, Secretary, Customs Budget, FBR.

⁴Although this measure has some drawbacks as it does not take into account the significance of various products like high tariff on insignificant products might overstate the degree of protection, but still is widely used as measure of protection.

or part of it. It illustrates the level of protection applied by a country or region, on average. Higher average tariff signifies higher protection and lower values reflect less protected economy. South Asia is the most protected region with average tariff more than 13% as compared to only 7.1% in the world. But it is near to 12.1% for low income countries. Pakistan falls slightly above the South Asian region average tariff which reflects higher protection.

Average Tariff Rates---Agriculture Vs Non-Agriculture

It is evident from Table 3 that average tariff rate for agricultural sector in Pakistan is quite low as compared to all South Asian economies except Nepal. It implies that Pakistan has exhibited greater liberalization of agriculture sector. Among all the South Asian countries, India and Bhutan provide higher protection to the agriculture sector. On the other hand, Pakistan average tariff for non-agriculture sector is lower than Bangladesh, Bhutan, and Maldives but higher than India, Sri Lanka and Nepal.

Table 3: Average Tariff (%) in South Asian Countries

Sectors	Sri						
	Pakistan	India	Lanka	Bangladesh	Bhutan	Maldives	Nepal
Agriculture	15.4	32.2	25.5	17.6	41.4	18.3	14.8
Non-Agriculture	13.2	10.1	9.0	14.3	18.9	20.7	12.4
Total	13.5	13.0	11.2	14.8	21.9	20.4	12.7

Source: World Tariff Profiles, 2009

Another change within the customs duty framework in Pakistan has been the drifting down of commodities from high tariff slabs to lower slabs. This change was essential to have proper cascading between primary, semi-manufactured and manufactured products. The evidence from Table 4 confirms that until 2000-01, no commodity was subjected to 5% rate of duty. However, it was introduced in 2001-02 and covered

1/5th of total tariff lines and this share had gone up to more than 1/3rd of total tariff lines since 2006-07 to 2009-10. This change has been at the expense of commodities previously subject to 10% and 20% rates of duty. The slab @25% as maximum tariff has been from 2003-04 to 2007-08. The proportion of tariff lines facing tariff of 25% has also declined from around 39% in 2003-04 to 12.8% in 2009-10. On the other hand, creation of maximum tariff slab 35% has shared more than 8 percent in 2009-10.

Table 4: Structure of Tariff Lines (%)										
Tariff Band	95-96	00-01	01-02	03-04	04-05	05-06	06-07	07-08	08-09	09-10
5	0.0	0.0	10.0	18.1	24.4	38.7	38.9	33.8	34.2	34.0
10	3.3	26.0	31.8	27.0	23.1	14.8	12.8	12.6	12.8	12.8
15	6.8	7.7	0.0	14.1	14.5	5.4	5.9	7.0	6.8	6.9
20	2.5	0.0	0.0	13.1	16.4	12.9	13.4	13.4	12.8	12.7
25	10.7	19.1	16.9	38.5	34.0	24.3	20.8	19.4	15.9	16.1
30	0.3	0.0	38.7	0.2	0.2	0.2	0.6	0.4	1.1	1.1
35	11.8	40.9	0.0	0.0	1.4	1.3	5.4	5.5	8.0	8.1
Sub										
Total	35.4	93.7	97.4	97.9	97.5	97.6	97.7	92.0	91.7	91.7
Others	64.6	6.3	2.6	2.1	2.5	2.4	2.3	8.0	8.3	8.3
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

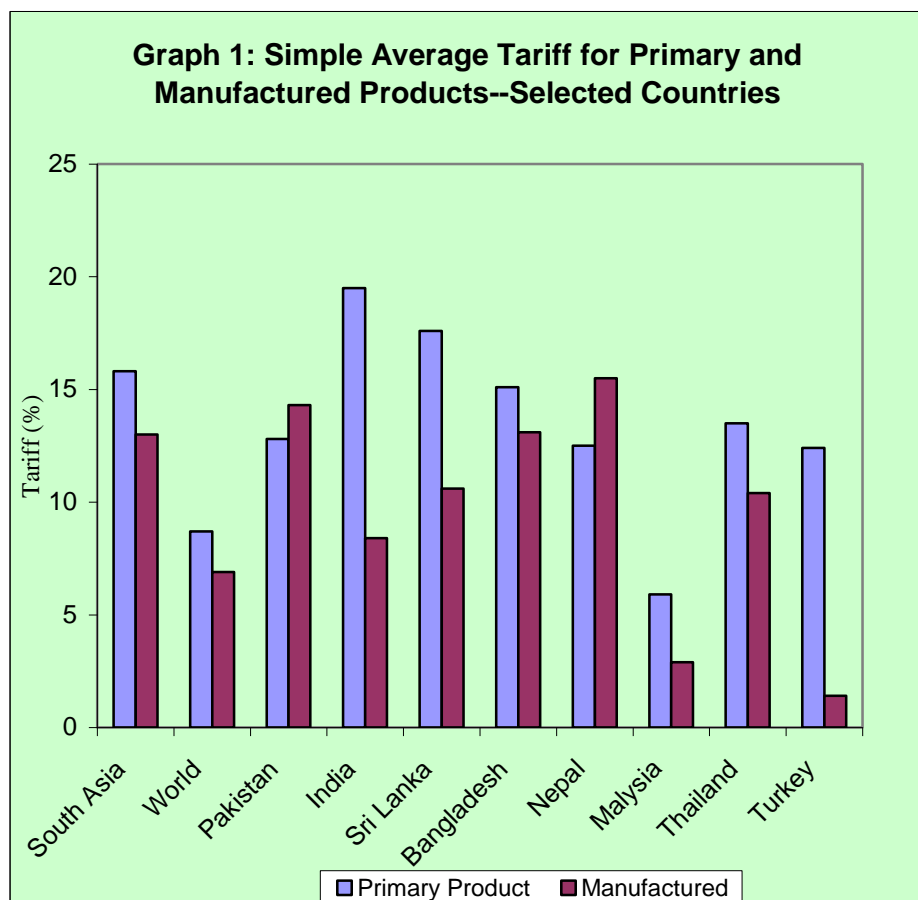
Source: Author calculations

Another development noticed in the recent years is that a new slab of 0% has also been created in Budget 2007-08 to simplify the tariff regime by picking items from SROs with zero rated duty and making them a part of the Pakistan Customs Tariff. In the same year, tariff classification scheme was also aligned with HS 2007 Version. Moreover, tariff peaks have also been curtailed. These tariff peaks apply mainly in the automobile sector and beverages. Only 74 tariff lines (tariff peaks) are higher than maximum rate of duty @35. In fact, tariff peaks constitutes only 1.1% of the total tariff lines. At present,

these peaks are still carrying higher rates and are being gradually reduced

As far as specific duty rates are concerned, these have been concentrated mainly in edible oils (Chapter 15) of the customs tariff. There are 45 tariff lines subject to the specific rates and their effective duty rates are extremely higher and may correspond to tariff peaks as well. *Advalorem* rates are quite easy to administer and there is a need to transform them into *advalorem* duty rates.

Graph 1 reveals that Pakistan provides higher protection to the manufacturing sector than India, Sri Lanka, Malaysia, Thailand and Turkey.



Source: World Development Indicators 2010.

An Argument for Uniform Tariff⁵

The application of uniform tariff is a debatable issue and has attracted the attention of tax policy makers and economist. Uniform tariff is a tariff schedule applied to nearly all products. Chile is a typical example of one of the leaders in application of uniform rate with greater success.

A single uniform tariff is highly attractive due to its numerous advantages as compared to escalated or de-escalated tariff. Equal protection for sectors eliminates classification problems and disputes. This will also lessen the administrative and legal cost of the importers. Uniform tariff will also simplify the claims of duty drawback payments. The advantage of uniform tariff is that it curtails the role of the special interest or special groups who exert pressure on the government for concession or lowering rates.

Moreover, it will also be helpful for the customs department to curb corruption by application of uniform rates and cost of collection will also be reduced. The empirical evidence provided by Roberta Gatti (1999), World Bank shows a robust association between standard deviation of trade tariff and measured corruption across countries, suggesting that a highly diversified trade tariff menu might actually fuel bribe taking behavior. By application of uniform low tariff rate, the smuggling will be minimized and customs revenues will be enhanced as imports will be diverted from illegal to legal route.

Due to paucity of resources, it is very difficult to adopt such an option in Pakistan when revenue loss is involved, especially, from imports where no effort is required. By mitigating this concern, only revenue neutral option of uniform tariff will probably be acceptable. Similarly, it is also difficult to apply uniform tariff on all the imports by withdrawing all the exemptions at once. On the other hand, if we take

⁵ See for more details on argument against and favour of uniform tariff, Davis G. Tarr (2000): "On the Design of Tariff Policy: A practical guide to the Arguments for and Against Uniform Tariff".

customs to GDP at ratio 1.1% and dutiable import to the GDP at 10.21%, so uniform rate for 2008-09 is estimated to be around 10.8%. This will be a revenue neutral uniform tariff rate which will make no harm to the collection from customs duties receipts.

Unprecedented Hike in Duty Free Imports and Alarming Cost of Exemption

Exemptions of customs duties have been granted in the form of SROs and statutory exemptions/ Zero rating. Zero rating although different from exemptions, but also entails revenue foregone. The major exemptions relate to raw materials and components; plant and machinery and equipment imported by high tech and priority and value added industries, energy sector projects and oil exploration and production companies etc. Some exemptions also relates to the international agencies and selected countries as part of international commitment. A huge amount of Rs.73 billion has been estimated as cost of exemptions for 2008-09 on account of customs duties. Interestingly, the cost of exemption for zero rated items has not been included in this estimate.

An attempt has been made to tailor all the cost of exemptions on account of customs provided through SROs into PCT Chapters by integrating one customs and PACCS data for 2008-09. Similarly, chapter-wise details in case of India were also retrieved for 2008-09. For apple to apple comparison, the shares of major cost of exemptions in both the countries calculated and presented in Table 5.

Chapter-wise structure of cost of exemption reveals vast divergence of policy in Pakistan and India. For instance, Pakistan has foregone 1/5th of revenue from exemptions granted to the automobile (Ch: 87) against only 1.3% in India during 2008-09. Top cost of exemption in India pertains to the POL products (Ch: 27) i.e. 21% while it is only 5.6% in Pakistan. On the other hand, significant share of 25.5% in machinery is almost doubled than India. In Pakistan, other major cost of exemptions

shares goes to cereals, articles of iron and steel, organic chemicals etc. On the other hand, India's other major cost of exemption are related to precious stones/metals (Ch: 71), and edible oils (Ch: 15).

Table 5: India Vs Pakistan: Chapter-wise shares of Cost of Exemptions During FY: 2008-09

(Share in Percent)

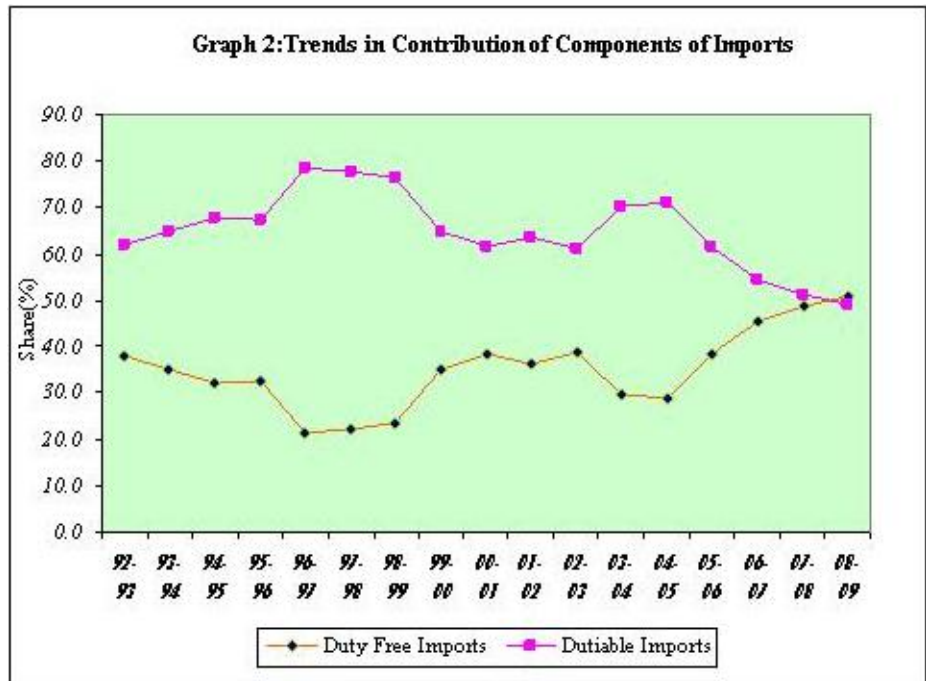
Chapters	Description	Pak	India
87	Vehicles (Non-Railway)	21.4	1.3
84	Machinery and Mechanical Appliances	17.4	8.2
85	Electrical Machinery	8.1	5.6
10	Cereals	7.3	0.0
27	POL Products*	5.6	21.0
73	Articles of Iron and Steel	4.3	1.5
29	Organic Chemicals	3.7	3.4
15	Edible Oil	2.9	9.5
71	Precious Stones/Metals	2.6	12.2
17	Sugars, Confectionery	2.5	0.2
72	Iron and Steel	2.4	3.8
28	Organic/Inorganic Chemicals	2.1	2.2
30	Pharmaceutical Products	2.0	1.5
39	Plastic Resins etc.	1.7	1.4
23	Food Industries Residues/Waste	1.3	0.1
94	Furniture; Mattresses	1.1	0.1
96	Misc Manufactured Articles	1.0	0.1
55	Staple Fibres	0.9	0.2
48	Paper & Paperboard	0.7	0.6
26	Orses, Slag, Ash	0.7	3.9
37	Photographic Goods	0.7	0.1
90	Optical, Photographic	0.6	1.5
40	Rubber Products	0.5	0.6
89	Ships, Boats	0.5	1.1
19	Cereals, Flour, Starch or Milk	0.5	0.0
54	Textile Materials	0.5	1.7
88	Aircraft	0.5	0.9
31	Fertilizers*	0.0	6.3
07	Edible Vegetables, Roots, Tubers	0.0	1.6
	Sub Total	93.8	90.6
	Others	6.2	9.4
	Total	100.0	100.0

Source: Pakistan: Author calculations based i) PRAL and PACCS data on cost of exemption

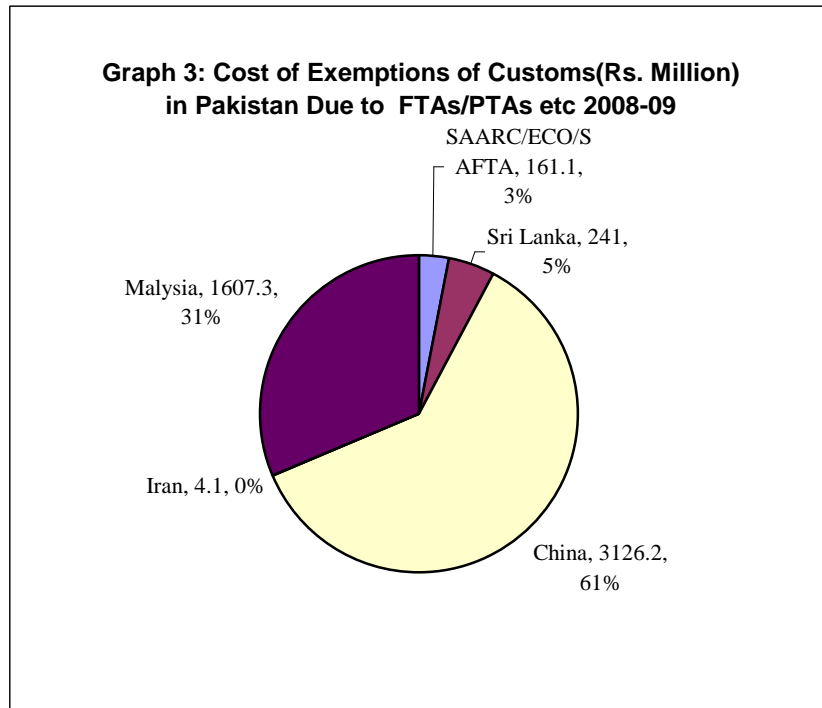
ii) India Receipts Budget 2009-10.

*As fertilizer and crude oil are zero rated but not exempted through SROs, therefore, not included in Pakistan data for comparison.

Historically, the contribution of dutiable imports has been comparatively higher than duty free imports. In the recent years, the situation has changed as the duty free imports (including zero rated) are now more than half of the total imports. This fact is evident from Graph 2 that share of duty free imports has started picking up strongly in 2005-06 and even crossed dutiable imports in 2008-09 which is alarming.



Pakistan has made arrangements with some countries like FTAs, PTAs etc. As far as cost of exemptions due to these agreements is concerned, the revenue foregone during 2008-09 is spotlighted in Graph 3.



The exemptions and concessions provided to them constitutes around 7% of the total cost of exemption of customs while volume of imports exempted due to these arrangements constitutes around 16% of the total exempted imports for 2008-09.

Conclusion

Although Pakistan has made efforts to reform its tariff for greater trade liberalization, yet a lot to be done. The tariff was slashed down significantly in the 90s and 2000s. The import was improved to a great extent due to liberalization policy but export could not signal marked improvement as a whole. So Pakistan could not achieve high level of openness as compared to neighbors India, Bangladesh and Sri Lanka.

Despite large scale tariff rationalization, Pakistan still have average tariff rates higher than competing countries of the region like India and Sri Lanka. For greater competition and openness, Pakistan has to slash down its maximum tariff around 15% against 10% recommended by the World Bank in Pakistan Tax Policy Report released in July 2009.

Although Pakistan has low average tariff for agriculture but manufacturing sector tariff is comparative higher. Pakistan's escalated tariff will be helpful in the short run but it will be harmful for the long run. Low tariff will be helpful in reducing dispersion & smuggling, discouraging lobbying for reduced rates and eliminating corruption in customs department. Another encouraging side of trade liberalization is that tariff reduction has cast welfare enhancing impact on the household income, increased labour and capital as well (Rizwana and Zafar Iqbal 2001).

In the face of high dispersion, an argument can be made for revenue neutral tariff rate in Pakistan. This will provide protection to the whole industry and eliminate distortion in the system. In case of its infeasibility in the short run, instead of all imports, uniform tariff can be applied to the dutiable imports. It will also discourage smuggling, corruption, under invoicing and lobbying for reducing rates etc.

One of the serious issues surfaced in this article is the unprecedented surge in the duty free import which surpassed dutiable imports for the first time. High cost of exemptions in customs warrants revisiting all the exemptions and as far possible, many of these may be withdrawn. A huge cost of exemption in no way justifies when viewed in the context of resource shortage with the government. All the zero rated primary good may be brought into a lower rate of 2.5% as in Sri Lanka. This will not only provide fairness in the system but also be helpful in raising revenues. The cost of exemption in Pakistan has mostly been concentrated in automobile, machinery, cereals and articles of iron and steel. On the other hand, Indian priority on cost of exemption is in the petroleum, machinery, precious stones/metals, and edible oils. The impression that FTAs/PTAs are incurring huge losses to the customs duty due to special exemptions is misplaced to a great extent.

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