Automobile Sector of Pakistan

Contents

Profile:

The automobile sector plays pivotal role in the development of a country in terms of revenue generation, foreign exchange, employment creation, and technology transfer. The share of Auto Sector to GDP is around $ 3.6 Billion. The automobile sector of Pakistan was deregulated in the early 90s after which major foreign automakers, through Joint ventures with local partners, made investments in Pakistan. Currently the major automakers in Pakistan include:

- Pak Suzuki Motor Company Ltd.
- Indus Motor Company Ltd.
- Honda Atlas Cars (Pakistan) Ltd.
- Dewan Farooque Motors Ltd.
- Sigma Motors (Pvt) Ltd.
- Hinopak Motors Ltd.
- Ghandhara Nissan Ltd

The automotive sector has deep forward and backward linkages: backward linkages in the form of reliance on a number of vendors for the supply of various components. It has forward linkages in the form of dealership networks and agents for the provision of after sales services. According to the Automotive Industry Development Programme (AIDP)[1] the auto industry economic and job multiplier in the Pakistani context is Rs1:3 and 1:8 respectively.

Production, Sales and Market Share:

When it comes to car sales, the automobile sector is dominated by three companies namely Pak Suzuki Motors, Indus Motors (Toyota), and Honda Atlas. The table below provides market share of three Major companies over the time:

	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Honda	18.04	12.65	13.13	17.89	16.95	10.15	8.62
Suzuki	50.48	54.52	53.67	53.01	55.67	61.09	62.18

[1] Prepared by the Engineering Development Board (EDB) in consultation with auto industry stakeholders and approved by the caretaker Government in November, 2007.

Toyota	21.02	26.31	26.18	23.48	23.14	26.84	27.84
Others	10.47	6.52	7.03	5.62	4.24	1.92	1.35
Total	100.00	100.00	100.01	100.00	100.00	100.00	99.99

Source: CCP Report, 2010

In 2008/09 the top-selling car with an engine capacity of 1,300cc or above was the Toyota Corolla, followed by two Honda models, the City and the Civic. Among smaller cars the biggest sellers were the Cultus, the Bolan and the Mehran, all made by Suzuki. Hyundai of South Korea and Daihatsu of Japan are also active in the market.

Looking at the trends of production and sales of cars, one can see significant increase over the time. Between 2001 and 2008 the car sale in Pakistan increased by 271%. The table below provides the details about production (P) and sales (S) since 2001:

1,300-1,600 cc PETROL AND 2,000 cc DIESEL								
		2001-02	**2002-03**	**2003-04**	**2004-05**	**2005-06**	**2006-07**	**2007-08**
Honda (Civic)	P	4,615	4,610	5,998	12,359	12,274	5,610	5,813
	S	4,625	4,637	6,097	12,352	11,998	6,513	5,762
Honda (City)	P	3,386	3,786	7,417	11,771	17,606	10,461	8,220
	S	3,382	3,749	7,271	11,714	16,136	11,848	8,439
Suzuki (Baleno)	P	1,240	2,608	4,153	5,965	2,939	0	0
	S	1,188	2,588	4,062	5,879	3,173	0	0
Suzuki (Liana)	P	~	~	~	~	5,370	5,964	2,605
	S	~	~	~	~	4,571	6,067	2,983
Toyota (Corolla)	P	5,763	12,861	20,525	23,007	31,094	35,036	33,672
	S	6,151	12,867	20,321	23,002	30,527	35,762	33,640
Nissan (Sunny)	P	81	51	26	0	0	0	0
	S	113	69	25	1	0	0	0
Kia (Classic NGV)	P	~	459	188	465	0	0	0
	S	~	687	81	546	0	0	0
Kia (Spectra)	P	2,091	384	73	1	0	0	0
	S	2,287	434	127	7	0	0	0

1,000 cc								
Suzuki (Khyber/ Cultus)	P	5,441	8,097	10,810	15,591	21,342	29,880	27,662
	S	5,637	7,927	10,795	15,611	21,390	29,837	27,563
Suzuki (Alto)	P	2,816	4,775	7,196	11,411	17,513	21,546	18,805
	S	3,072	4,701	7,148	11,431	16,823	21,988	19,097
Hyundai (Santro Plus)	P	1,667	3,114	7,902	6,101	8,604	2,225	2,028
	S	2,245	3,135	6,922	7,009	7,031	3,470	2,227
800cc								
Daihatsu (Cuore)	P	2,845	4,580	6,468	8,525	7,883	12,786	12,406
	S	3,174	4,579	6,339	8,592	7,883	12,776	12,204
Suzuki (Mehran)	P	10,143	16,748	27,705	31,207	35,433	36,988	36,249
	S	9,964	16,582	27,432	31,165	35,982	37,007	35,526
Suzuki (Bolan)	P	2,591	4,359	5,201	7,319	10,429	15,520	17,250
	S	2,540	4,360	5,228	7,241	10,451	15,566	17,209
TOTAL CARS	**P**	**42,679**	**66,432**	**103,662**	**133,722**	**170,487**	**176,016**	**164,710**

Employment figures for the industry, available only till the year 2004-05, released by Pakistan Automotive Manufacturers Association (PAMA), are given in the table below.

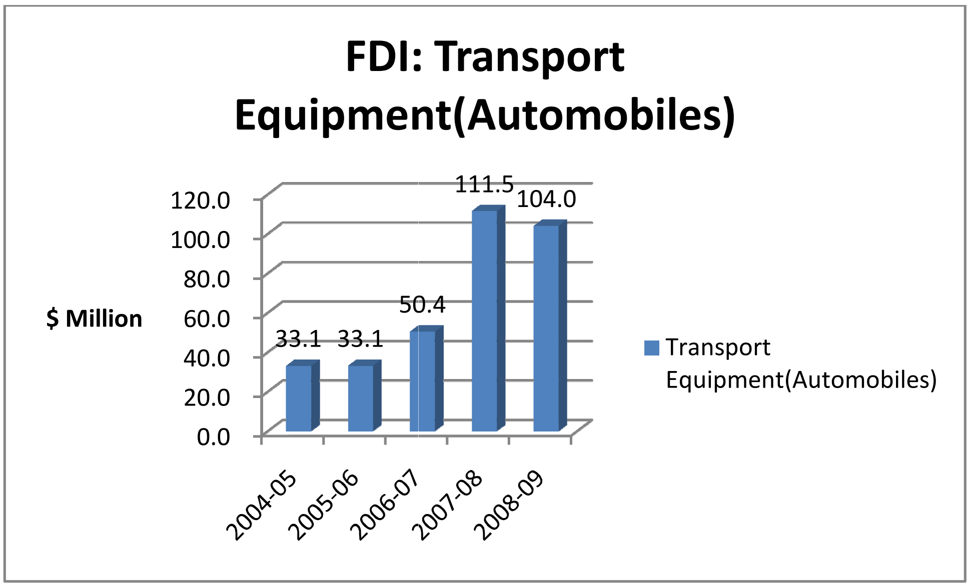
Employment in the auto industry -Cars, Jeeps and buses subsector[2] (Employee No.)					
	2000-01	**2001-02**	**2002-03**	**2003-04**	**2004-05**
Pak Suzuki Motor Company Ltd.	1,144	1,130	1,109	1,378	1,723
Indus Motor Company Ltd.	628	697	1,021	1,226	1,429
Honda Atlas Cars (Pakistan) Ltd.	431	470	477	625	1,032
Sigma Motors (Pvt) Ltd.	15	46	73	112	159
Hinopak Motors Ltd.	0	223	84	541	101
Ghandhara Nissan Ltd.	127	88	72	240	255
Total Employment	**2,345**	**2,654**	**2,836**	**4,122**	**4,699**
Source: PAMA					

[2] Data for Ghandhara Nissan are unavailable

The table shows that direct employment in the industry has risen by over 100% between 2000-01 and 2004-05.

Foreign Direct Investment:

Foreign Direct Investment (FDI) figures for the auto sector are provided in the figure below. The figure shows that FDI in the sector rose by 121% between the years 06-07 and 07-08. Although FDI fell in 08-09 but it was still at a healthy level of $104 million. FDI in this sector accounts for on average only 1.56% of total FDI into Pakistan.



Source: State Bank of Pakistan

The auto sector of Pakistan has gone through 2 phases-the 1st phase (1985-05) was known as the preparation phase. During this phase the auto industry had to phase compulsory local content conditions known as deletion programmes. In each of the Industry Specific Deletion Programmes (ISDP) and Product Specific Deletion Programmes (PSDP) each vehicle model had to meet compulsory local content conditions. If these conditions were not met the Government would charge the CBU (Complete Built Up) rate for imported contents that were not indigenized at that point in time. The policy behind these programmes was one of import substitution, job creation and investment.

However the deletion programme was not deemed to be TRIMs compliant and in 2006 the GoP replaced it with Tariff Based Measures marking the start of the next phase in the life of the auto industry dubbed the Development Phase. The basic framework of the Tariff Based System is:

1. Imports in CKD condition would be allowed only to assemblers having adequate assembly.
2. Parts/ components indigenized by June 2004 have been placed at higher rate of Customs Duty.
3. Parts not indigenized would be allowed at CKD rate of Custom Duty[3].

Vendors:

According to the AIDP there are 200 recognized vendors in Pakistan supplying directly to assemblers and the same number of unorganized vendors who then cater for the needs of these vendors. Vendors are mainly SMEs. Due to the lack of scale in the auto assembly sector, vendors could not achieve economies of scale. There was also little incentive for vendors to invest in higher productivity as their premiums were high due to local content requirements and the tariffs on components produced indigenously were very high. The GoP currently supports vendors through relaxation of custom duties on the import of inputs and duty free import of raw materials.

Pakistani vendors produce mainly low value added components namely: Sheet metal parts, wire harnessing, interior trims, seats, rubber and plastic parts, batteries, wheel rims, tyres, lighting accessories etc. The lack of specialization in higher value products can be attributed to the fact that technologies for production of sophisticated components are licensed, the acquisition of which involves high costs. Other factors include:

- Lack of availability of local raw materials.
- Lack of trained workforce.

It is estimated that the production value of this industry is $1 billion[4].

[3] Sourced from Engineering Development Board (EDB)
[4] Sourced from AIDP Report. The figure is estimated for the year 2005-06.

Import Restrictions:

Imports duties in auto sector have traditionally been high making imported cars too expensive to import. The overall imports contracted in 2009 on account of the imposition of higher import duties as well as the steep depreciation of the Pakistan rupee against the US dollar, which made imports more expensive.

In order to protect the domestic manufacturer's competitive advantage, customs duty on CBU's remains at 50% up to 800cc cars, 55% up to 1000cc cars, 60 % up to 1500cc cars, 75% up to 1800cc cars, and 100% for cars exceeding 1800cc cars. An additional regulatory duty of 50%.for luxury cars that exceed 1800cc.has been imposed. In contrast the duty on CKD is between 32.5% to 50% giving the domestic manufacturers a protection of around 17.5% to 117.5 %.

Tariff Plan:

There are a total of 480 tariff lines for the auto sector out of which 418 new tariff lines were created for parts and components. These entire tariff lines are on Pakistan's sensitive lists vis a vis its various trade agreements.

In the budget of 2007-08 the Government approved a 5 year tariff plan for the sector which included components, CKD kits and CBUs. Details of the tariff rates at the tariff line level are presented in the Appendix. Under SRO 693 2006 the certain tariff headings would be subject to additional customs duties varying from 35% to 17.5%.

The additional custom duties are on the following categories:

HS 8701—Tractors
HS 8702 – Buses (CBU)
HS 8703 – Cars (CBU)
HS 8704 – Trucks
HS 8711 – Motorcycles
Author's Calculation based on the Pakistan Customs Tariff Schedules

Some tariff lines also face regulatory duty ranging from 15% to 25% (in the case of HS 8703 Cars). The tariff headings that face regulatory duties are:

HS 8703 – Cars (CBU)
HS8704 – Trucks
HS 8706—Chassis fitted with Engines
HS 8707 – Bodies for Motor Vehicles
HS 8708—Parts and Accessories of Motor Vehicles
Author's Calculation based on the Pakistan Customs Tariff Schedules

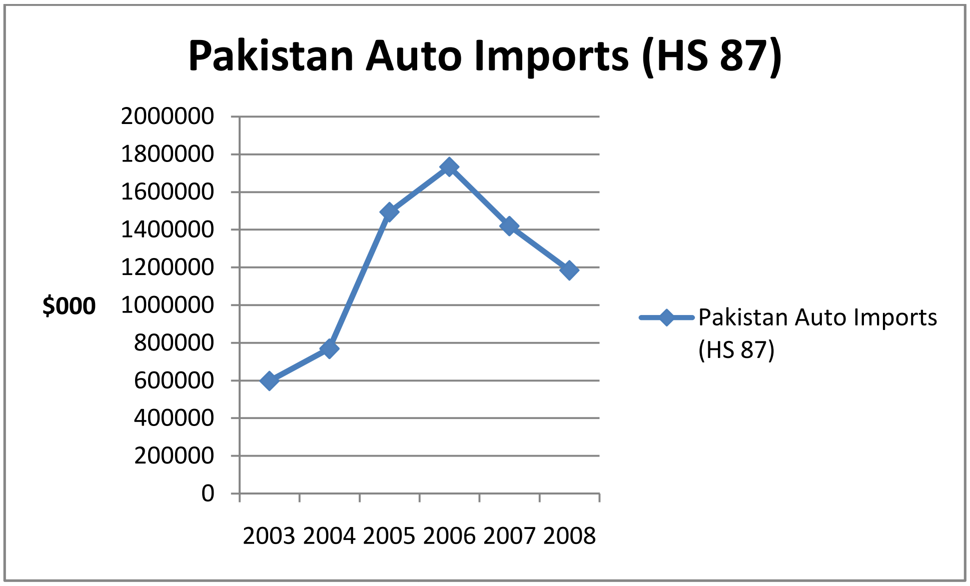
According to the Consolidated Tariff Schedule (CTS), of the WTO, Pakistan has left some tariff lines relating to the auto sector bound and others unbound. In the event of a potential Doha deal Pakistan would have to: (a) Bind the previously unbound tariff lines in the auto sector. According to the latest negotiating modalities of NAMA this would have to be the MFN tariffs in the base period 2001 with a markup of 5 %. (b) Although Pakistan does not have to make any cuts under NAMA, the additional custom duties and regulatory duties may not be WTO compliant.

Tariff Revenue Generated by Auto Sector:

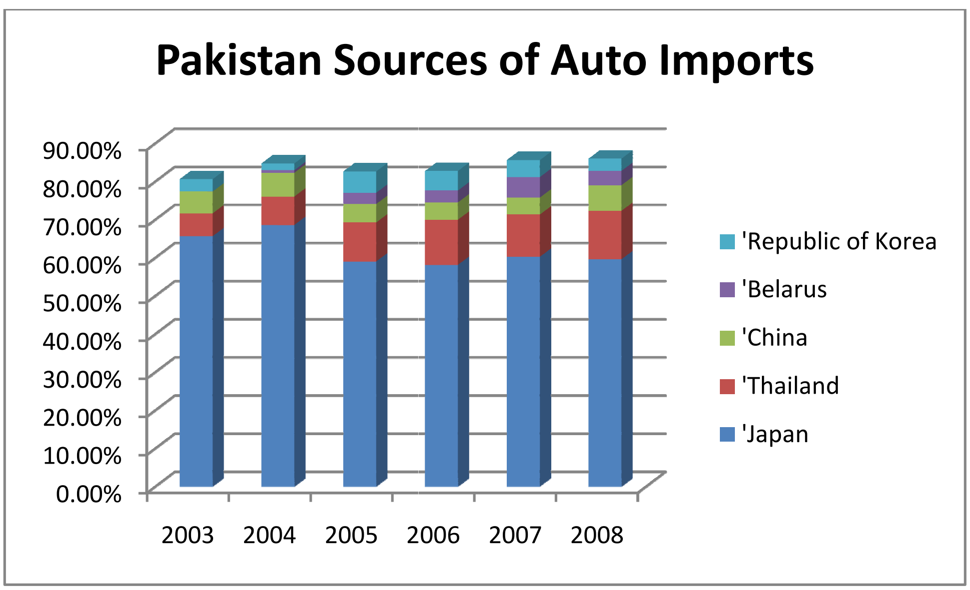
The following data regarding auto sector imports was extracted from Customs data for the year 2008-09.

2008-09	**Rs. Billion**
Total Auto imports	68.269
Tariff revenue collected	16.995
Auto imports as a % of total imports	2.50%
Tariff revenue from Auto Sector as % of total tariff revenue collected	12.36%

Auto Sector Trade Profile-Imports



Source: Trade Map

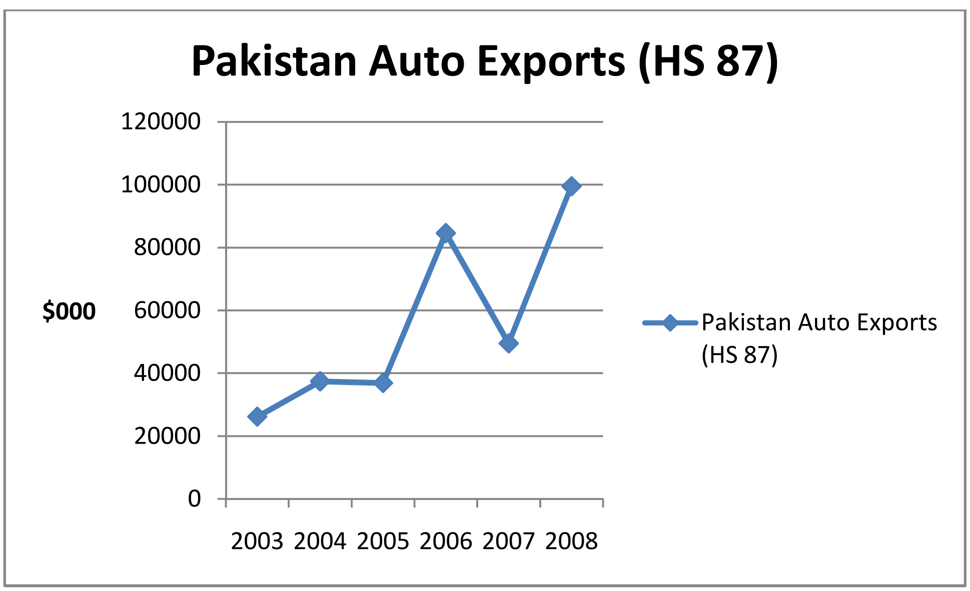


Source: Trade Map

The largest source of Auto imports for Pakistan is Japan which in 2008 accounted for 59.5% of total auto imports of Pakistan this amount can be attributed to the fact that the major auto companies in Pakistan are in partnership with Japanese auto companies e.g. Suzuki, Honda and Toyota. Cars falling under HS 8703 (CKD and CBU) account for approximately 59% of total auto imports from Japan. Motorcycle accessories and Motorcycle side cars account for roughly 50% of Pakistan's Auto imports from China. The other major category is under HS 8708 (Parts and accessories of Cars) and has a share of 22% in Pakistan's Auto imports from China. The only imports from Belarus are tractors under codes HS 8701 (CBU).

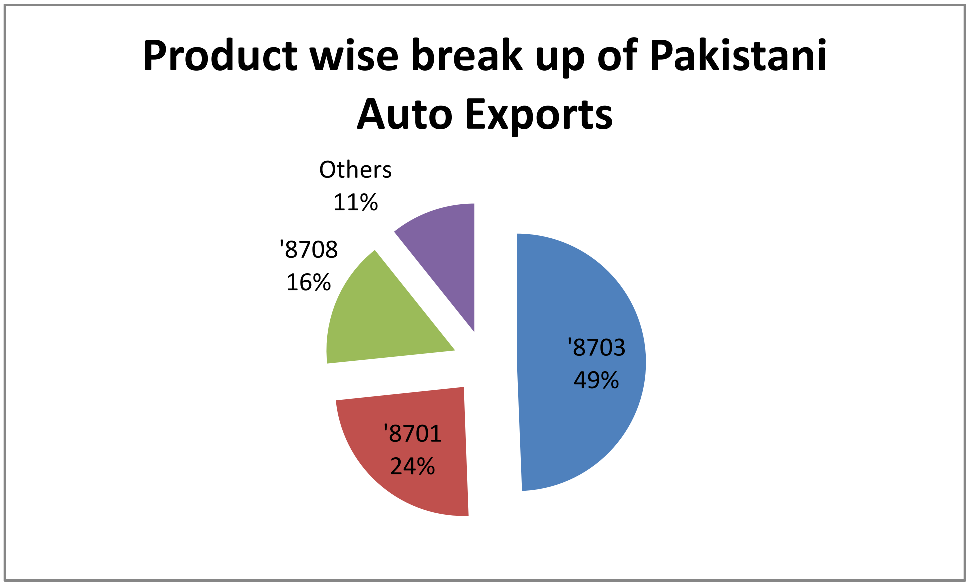
Thailand's share in Pakistan's auto imports is increasing over time and in 2008 this share was 12.7%. The reason for this is that today all leading Japanese car producers as well as BMW, Mercedes Benz, General Motors, Ford, Volvo and Peugeot assemble cars in Thailand along with their legions of suppliers. Thailand has become the main production base for auto exports in South East Asia. About 50% of Auto imports from Thailand comprise Cars under HS 8703 (CBU, CKD) and 25% of parts and accessories of Cars.

Auto Sector Trade Profile-Exports



Source: Trade Map

The size of Pakistani Auto exports is relatively small as compared to imports in this sector. In 2008 Pakistan these exports were valued at $99.45 million. The figure below shows the major export products which are under HS 8703 (Cars CBU,CKD). The major export markets are turkey which has a share of 49%, followed by the UAE (7.8%) and Nigeria (7.5%).



Source: Trade Map

Government Policy:

In 2004 the government has permitted imports of reconditioned cars to meet the excess demand. The import policy presented in October 2006 allowed the import of three year old used cars. Rules for importation of used cars were also formulated which provided that import of vehicles can be made under the gift, personal baggage and transfer of residence scheme. The Pakistani automobile industry reacted against the import policy changes. The PAMA and the PAAPAM said that it would be a massive setback for the country's native manufacturing plants.[5] However, government back then tackled the objections raised by the automobile industry on the ground that there is a 30,000-40,000 gap in the supply of new cars in Pakistan which leads to inflated prices and a long time to wait for delivery. These changes would ease the burden on consumers. The government also, increased the depreciation allowance on used car imports to two from one

[5] http://www.usedcarspakistan.com/2006/11/06/pakistani-government-revises-policy-on-importing-cars-to-pakistan/

per cent in the budget 2005-06. Later on condition of three years old vehicle was relaxed and Import of Vehicles Rules, 2008 allowed 5 years old vehicles also. Due to the rising prices of the cars in the domestic market, the government is considering to allow the import of cars used for more than ten years to bring down the prices and set a competition environment in the domestic automobile market.[6] However, there is constant pressure from automobile manufacturing sector to ban the import of used cars completely. However, there is constant pressure from automobile manufacturing sector to ban the import of used cars completely. They say that the ban will help local manufacturers to boost sales and when volumes grow the production cost will go down, thus benefiting the end user.[7] Eventually they have been successful in one or the other way to restrict the import of used cars. The Federal Board of Revenue has reduced the depreciation rate from 2% to just 1%[8] on the import of used cars. This decision to make 50% reduction in depreciation rate would increase overall rates of duties and taxes on the import of old and used vehicles. On the other hand assemblers have failed to bridge the gap between supply and demand especially of the small car category which is in higher demand.

However, the experience shows that imports of used car often raised the issue of non-availability of spare parts as well and these cars in longer run become unserviceable. Apparently, there is not much benefit in allowing the imports of used cars as it enables advanced countries to dump their discarded cars in countries like Pakistan. We can benefit from newer technologies by reducing tariffs on the import of new cars.

[6] http://pakobserver.net/200905/11/Editorial03.asp
[7] http://www.thenews.com.pk/print1.asp?id=210590
[8] SRO.577 (I)/2005 through a notification S.R.O.25(I)/2009 dated 12.01.2009

Comparison with Indian Automobile Sector:

	Similarities	Dissimilarities
Licensing Requirements	Both India and Pakistan have removed the requirement of obtaining licenses for investing in the automobile sector	
Development of Domestic industry and lesser dependency on Imports	Both countries want to promote local technology, promote local design development and manufacturing to make the sector internationally competitive and remove dependency on imports	
Type of Developments	The two sector visions are also similar in proposing the type of developments in sectors related to automobile sector. Both stress on road infrastructure development, introducing international quality standards in the sector, human resource development and growth in vending sector.	The visions, however, differ in the level of protection granted to their respective automobile sectors. Pakistan's automobile sector is relatively more protected than India's. India had to do away with protection particularly its conditions of indigenization and balance of trade requirements by year 2002. This had not happened voluntarily as India was taken to a WTO dispute panel by the US and the EU.
Openness	India, like Pakistan, has also put in place import tariffs on parts	However, these tariffs are, on average, half of what they are in

	that are manufactured in India.	Pakistan. Also, In contrast to Pakistan, Indian automobile sector is more open as it does not require its investors to promote compulsory indigenisation

Analysis:

- ***Indian Auto industry is more competitive than that of Pakistan's which has only has three major players each of which dominates a different segment of the market. Hence lack of Internal Competition has been witnessed in Pak Auto Sector. Pakistan aims at becoming internationally competitive in the Auto industry. For this to happen, it is important to become internally competitive first.***
- ***Pakistan has one important lesson to learn from India's automobile sector – those protectionist policies such as indigenisation leaves Pakistan's automobile sector vulnerable to interventions by international (read WTO) rules and regulations. Pakistan may find it difficult to defend its policies if it faces a situation similar to the Indian situation in the WTO dispute panel.***

Possible Causes of Rise in Auto Prices

- ### Absence of Genuine Competition:

The absence of genuine competition has let the local industry to dictate the market in terms of prices. The continuous price increases of local automobiles since 2006 has put new cars out of range of middle-income groups. Statistics depict a fall in sales on year on year and on a month on month basis. But the prices of the local manufactured vehicles are continuously increasing. The three leading manufacturers *i.e.* Honda, Indus Motors and Pak Suzuki increased their prices thrice in 2008.[9] It appears that they have adopted a strategy of increasing profits on limited production instead of increasing volumes. In the downstream market, dealers of the manufacturers/assemblers act as mere agents and have no real incentive to compete in the market. Competition in the automobile market can be improved significantly by allowing import of new cars at lower prices. This should be pursued with the current investment policy of attracting other car manufacturers in the country. Opening up imports will gives an opportunity to prospective future investors to understand the market and nature of the demand for their products before they make investments.

- ### Limited Production Capacity:

Production of cars in Pakistan takes place at just 16 manufacturing plants. Consumers often have to wait for months before receiving new cars. Most carmakers have been announcing plans to increase production volumes over the next few years but these plans have yet to come to fruition and late delivery and high premiums on locally assembled cars remains the major cause of increase prices and dissatisfaction among buyers.

- ### Appreciation of foreign currencies (Yen):

A recent increase has been felt in the prices of major Auto companies in Pakistan as a result of Yen appreciation against various currencies, making imports of parts and accessories expensive. The makers of Honda cars announced the price hike of Rs20,000 and Rs30,000, while for Civic (except Vtec manual), the rate has been enhanced by Rs30,000-35,000 on other versions. During the same period, Pak Suzuki Motor Company Limited (PSMCL) has raised the price of Swift by

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[9] http://www.opfblog.com/2455/car-prices-in-pakistan-raised-third-time-in-3-months/

Rs50, 000 to Rs1,049,000 from Rs999,000, while Indus Motor Company (IMC) had pushed up the rate of Toyota Corolla XLI by Rs20,000 and GLI and above 1,800cc by Rs30,000.

- ### Rise in Demand and Premium Charged:

There has been increased in demand for cars substantially due to three reasons – surging rural buying in the wake of good crops of cotton, wheat, rice etc, 17 per cent rise in home remittance to $5.786 billion in July-Feb 2009-10 and slight improvement in sale of cars through bank leasing to 25-26 per cent from 20 per cent few months back.

According to the figures released by Pakistan Automotive Manufacturers Association (PAMA), the production of locally assembled cars has raised to 74,871 units (excluding Suzuki Bolan) in July-Feb 2009-10 from 56,485 units in the same period of last fiscal. In February 2010 production has risen to 9,857 units from 5,733 in the same month of last year.

It has also been observed that the authorized dealers are openly charging premium from customers as many of them cannot wait for delivery period. Premium on Toyota Corolla XLI and GLI ranges between Rs 40, 000 to Rs 60, 000. There are also reports that some dealers are demanding premium of Rs 85, 000 on Corolla GLI. On Suzuki Mehran dealers are quoting Rs 20, 000-30,000 and on Alto, Cultus and Swift, premium hovers between Rs 10,000-20,000. Recently, Indus Motor Company (IMC) has asked the consumers to say no to premium and wait for the delivery of their cars as the company is continuously increasing its production to meet the demand.

For the last few months, the ministry has not taken any step against price hike, premium and quality with the assemblers. It has also been seen that some consumers, claiming to be genuine, are also lifting cars and selling them on premium. This has also resulted in the entry of new investors, middlemen and speculators in the auto market. To deal with this situation IMC has proposed the Ministry of industries to implement suggestions of mandatory registration for six months or heavy transfer fee in case of ownership changes within the first six months of purchase of vehicle to curtail the market malpractice of premium. There should be a legislation to prohibit premium charged by the manufacturers and the dealers

Conclusion:

There is a general perception that Auto assemblers are charging very high prices and Government has not taken significant measures to control auto Sector prices. However the Government has notified the industry several times since 2001-02 to cut their prices. The ministry of Industries and Production was engaged with the car assemblers since December 2002 for reduction in prices but no significant progress has been made in this regard.

Car imports are subject to excessively high duties. It is a common belief that with just a small number of manufacturers, Pakistan's auto industry cannot become competitive. Competition in the automobile market could be improved significantly by allowing import of new cars at lower prices. This should be pursued with the current investment policy of attracting other car manufacturers in the country. Opening up imports will gives an opportunity to prospective future investors to understand the market and nature of the demand for their products before they make investments.

The benefits of lowering tariffs on new cars will be many. One, it will make available greater options for the consumers who are currently stuck between a handful of models thereby increasing inter-brand competition. Two, it will introduce new technology to Pakistan and improve safety standards. Three, it will force the local manufacturers to compete in the market, improving quality and decreasing price. Four, it will enable the car dealership and parts and after sales services market to develop in order to cater to the increasing variety of cars and technology. These benefits will outweigh any potential other concerns regarding foreign exchange, loss of jobs and investment. Foreign exchange is already lost in the import of CKU's. In fact the local manufacturers are quick to point out that increasing prices are due to changes in exchange rate. Therefore there should not be any adverse affect on the foreign exchange reserves. If at all there is, it will be minimal[10].

[10] http://www.cc.gov.pk/images/reports/automobile_sector_study.pdf