

Making Pakistan's Auto-parts Sub-sector Competitive

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Introduction

Auto-parts is an industry sub-sector that dominates the automotive industry of Pakistan¹. Automobile parts and accessories are intricate components that make up all automobiles, allow them to run efficiently, and for a long time. The sub-sector constitutes approximately 2,000 Small Medium Enterprises (SMEs) producing auto parts for the local industry out of which only 400 are in the formal sector². The sector has shown positive development over the years with capital inflows and agreements with renowned equipment manufacturers for technology transfer³, which include components such as bumpers, radiators, mufflers, batteries, tyres, wheels, air-conditioners, wiring harnesses, instrument panels, steering wheels, sun visors, seats, carpets, interior panels, sheet metal, and plastic parts. These are produced locally by more than 400 vending companies, which employ nearly 2.2 million skilled workers directly or indirectly⁴.

The auto parts sub-sector is important because it has the potential to create backward linkages in the automotive industry, attract foreign direct investments (FDI) and domestic investments, create employment, and develop links with the service industry. Further, the auto parts sub-sector significantly promotes development in various affiliated industries⁵, primarily plastic, glass, fabrication,

steel, and iron as it needs to establish working relations and cooperative linkages with these industries. Lastly, as most of the SMEs operating in the automotive industry are related to auto-parts^{6, 7}, this sub-sector is critical for increasing the competitiveness of the overall automotive industry⁸.

In the case of Pakistan, the auto parts sub-sector has its own significance and dimensions. It provides an important opportunity for Pakistan to improve the competitiveness of its auto-industry, and boost exports by becoming a hub in the global auto-parts value chain, as auto parts manufacturing moves to low-cost countries⁹, and multinational corporations (MNCs) increasingly invest and outsource production to developing countries. Pakistan does have a presence of well-known industry brands such as Toyota, Honda, and Suzuki, and further Chinese and South Korean companies have also invested in joint ventures in the auto parts sub-sector to enhance export capability and import substitution¹⁰. This makes the auto-parts industry well placed both for employment generation and export earnings. However, this is dependent on the competitiveness of the domestic auto parts industry implying lower production costs and improved quality. This opportunity has been recognized by the government as it has launched two supportive policies for the sub-sector: the Automotive Development Policy of 2016-2021 and 2022-2026, and has set a \$1 billion export target for it by the year 2021.¹¹

¹ Mohammad Asif, "Diagnostic Study Autoparts Cluster Lahore - Pakistan," *Punjab Custer Development*, June 2006, <https://www.cdi.psic.gov.pk/reports/autoparts/LUMS%20Auto-Sector-Report.pdf>.

² Zeenat Hisam, "Auto Workers," *DAWN*, November 26, 2019, <https://www.dawn.com/news/1518887>.

³ Usman Hanif, "Auto Sector Growth Linked to 'Make in Pakistan,'" *The Express Tribune* (The Express Tribune, November 26, 2021), <https://tribune.com.pk/story/2331258/auto-sector-growth-linked-to-make-in-pakistan>; Mansoor Ahmad, "How Pak Auto-Part Vendors Are Setting Global Standards," *TheNews*, 2019, <https://www.thenews.com.pk/print/420289-how-local-auto-part-vendors-are-setting-global-standards>.

⁴ Pakbiz, "Auto Parts Manufacturers in Pakistan, Leading Exporters & Suppliers, Equipment Makers Companies," Accessed February 18, 2022, https://pakbiz.com/Auto-Parts_SID16.html.

⁵ Chen Caiyuan and Wang Long, "Research on Auto Parts Industry Upgrading Based on Internet of Things," *The Open Electrical & Electronic Engineering Journal*, 9, no. 1, (2015): 474–78, <https://doi.org/10.2174/1874129001509010474>.

⁶ Mohd Rosli M, "Determinants of Small and Medium Enterprises Performance in the Malaysian Auto-Parts Industry," *African Journal of Business Management*, 5, no. 20, (2013): pp. 8235-8241, <https://doi.org/10.5897/ajbm11.889>;

⁷ Richard F Doner, Gregory W. Noble, and John Ravenhill. "Industrial competitiveness of the auto parts industries in four large Asian countries: The role of government policy in a challenging international environment." *World Bank Publications*, Vol. 4106, 2006.

⁸ John Humphrey and Hubert Schmitz, "How Does Insertion in Global Value Chains Affect Upgrading in Industrial Clusters?," *Regional Studies*, 36, no. 9, (2002): 1017–27, <https://doi.org/10.1080/0034340022000022198>.

⁹ Teresa Poon, "Beyond the Global Production Networks: A Case of Further Upgrading of Taiwan's Information Technology Industry," *International Journal of Technology and Globalisation*, 1, no. 1 (2004): 130, <https://doi.org/10.1504/ijtg.2004.004555>.

¹⁰ Usman Hanif, "Pakistan Sets \$1b Target for Export of Auto Parts over 5 Years," *The Express Tribune*, April 8, 2019, <https://tribune.com.pk/story/1946266/pakistan-sets-1b-target-export-auto-parts-5-years>.

¹¹ Ibid

Table 1: Snapshot of the Auto Parts Sub-sector

Year	2019	2020	2021
Estimated Capital Investment (PKR millions)	35,991	48,280	56,319
Import Value (USD millions)	514	263	405
Export Value (USD millions)	172	160	201

Source: PACRA 2021¹²

However, Table 1 indicates a low level of exports as compared to imports along with a mix trend in the direction of both imports and exports, raising questions about the competitiveness¹³ of the industry, attested to by the Competition Commission of Pakistan (CCP) which deemed the sector uncompetitive in 2018.

Overall, Pakistan's auto parts sub-sector is important for the development of the domestic auto industry as well as for a positive impact on the long-run industrial development and growth of the country. The sector is labour intensive which can generate employment for skilled, unskilled, and semi-skilled workers, and can bring in more foreign exchange through its export potential. However, despite being provided with protection through various industrial policies along with the availability of keen investors, labour and other resources, the sub-sector has remained uncompetitive and underperforming.

Research Objective & Methodology:

The research objective was to explore the nature of competitiveness and productivity of the auto-parts sub-sector so as to identify the causes of its un-competitiveness, and possible opportunities for sector development. A qualitative methodology involving cross-sectional research methods spanning in-depth interviews and focus group discussions was used to unearth explorative aspects, as limited literature was available for Pakistan's auto-parts sub-sector along with the non-availability of reliable and consistent data. Specifically, eighteen interviews of retailers, wholesalers, manufacturers, vendors, and service providers; three interviews of public sector leaders, and seven interviews of members of Pakistan Automobile Spare Part Importer & Dealer Association (PASPIDA) and Pakistan

Association of Automotive Parts & Accessories Manufacturers (PAAPAM) were conducted.

Key Research Findings

Policy Evolution & Incoherence

The biggest policy weakness is that the auto-parts sub-sector has had minimal representation in the policy discourse which has instead been dominated by Original Equipment Manufacturers (OEMs) and importers, while domestic producers have not been given much leverage in the policies.

The previous policy of 2016–2021 encouraged new entrants in the auto parts sector and also the local assembly sector. As a result, growth was observed in both sectors, but there were high imports of auto parts as the policy offered concessionary rates on auto parts imports.¹⁴

By promoting value addition, localization, and the local vendor sector, the 2022–2026 auto parts policy hopes to draw in multinational corporations and create jobs. It aims to make the auto sector more competitive by focusing on regional suppliers and boosting exports. However, for this purpose, policy initiatives are also needed for the informal sector to improve overall productivity.

Further, the current state of the world market might change investment tendencies, and five years might not be long enough. The gestation period of the auto-parts industry is 10 to 12 years, while the policy spans five years only. For instance, auto fares are important as local manufacturers receive international orders through associated networking. The Trade Development Authority of

¹² https://www.pacra.com/sector_research/Automotive%20Parts%20-%20PA

¹³ Final Report "The Automotive Sector of Pakistan", 2011; World Bank Policy Brief, 2015

¹⁴ Usman Hanif, "Auto Sector Growth Linked to 'Make in Pakistan,'" The Express Tribune (The Express Tribune, November 26, 2021), <https://tribune.com.pk/story/2331258/auto-sector-growth-linked-to-make-in-pakistan>.

¹⁵ Association Member-PAAPAM and APM, SBP on SME Financing, Meeting at Lahore Chamber of Commerce, Lahore, December 15, 2022

Pakistan picks and sends a different set of manufacturers from a list provided by the association, much like a lucky draw.¹⁵ But, as a stakeholder suggests, even the participation in international fares needs to be consistent with the gestation period.

“For fares, the same manufacturer needs to attend for 10 to 12 years consecutively; only then can he attract customers. When the customer sees the same manufacturer in the fare for ten years, let’s say, trust will be built between the manufacturer and the customer, and this will be the point when the trade will begin. The previous governments sent about fifteen manufacturers; during PTI’s tenure, the number was reduced to two and nil for last year, and then two again for this year.

The other thing is the stall setting. I have seen stalls for other developing countries like India, which have better arrangement than ours; ours is like a civil hospital unfortunately. The government needs to understand that presentation and stall location impact the customers”¹⁶

Protection

The protectionist policy in Pakistan is criticized for restricting growth in the local parts sector. With a 35% protection on parts and additional duties set aside, protection is primarily given to OEMs, with an established supply chain and no after-market. This has created hurdles for localization and worsened local manufacturing as the policy divides large and small firms into formal and informal sectors, where large firms are protected while small firms lack support even though the smaller firms outperform the large ones. Instead, the protected firms gain larger financial returns, leading to lower exports.

Lack of Support to the SME Sector

Small and Medium Enterprises (SMEs) are crucial for the growth and development of the sector. But the policies do not cater to them. The Statutory Regulatory Orders (SROs) are mainly provided to Large Scale Manufacturers and OEMs for importing raw materials and redeeming

duties. Similarly, some exporting companies get tax relief by showing their imports as inputs. However, the SME sector does not have this kind of policy support. These are mostly small-scale enterprises spanning the semi-formal or the informal sector. Instead, policies in China, Taiwan, Thailand, and Malaysia support the overall parts sector of the country. These countries support SMEs through various provisions such as the acquisition of raw material. Thus, even local buyers from Pakistan buy from these SMEs to offset their purchasing power barrier while large-scale manufacturing is limited to select brands.

The SMEs in auto-parts industry also do not get any financial support¹⁷ which limits their growth.¹⁸ Although the SME Policy of 2021 does promise support to SMEs,¹⁹ still the auto-parts sub-sector has limited representation in the policy domain while support is usually provided to low value-added but export-generating sectors like textile.

Inconsistent policies

There are high levels of inconsistency among subsequent policy regimes. As a policy is for five years against a gestation period of ten to twelve years for the auto-parts industry, its implementation is time-lagged; and it is heavily influenced by interest groups close to the ruling party who invariably change in the next political cycle. Thus, before the policy is fully implemented, a new policy is introduced which leaves the previous policy outcomes in the lurch along with no possibility of accountability for policymakers of the last policy. Instead, investors and entrepreneurs require a consistent policy regime for a much longer timeframe.

Political Instability

Political instability is another barrier to the growth of the local industry. Political turmoil in the country leads to economic turmoil and instability in the market. Frequent changes in policy resulting from political instability in the country lead to the desertion of previous policies before they can produce results. As a consequence, the after-market segment is particularly adversely affected by these shifts.

¹⁵ Association Member-PAAPAM and APM, SBP on SME Financing, Meeting at Lahore Chamber of Commerce, Lahore, December 15, 2022

¹⁶ Association Member-PAAPAM, interview by author, PAAPAM office Lahore, December 20, 2022.

¹⁷ Association Member-PAAPAM and APM, SBP on SME financing, conversation with author at Lahore Chamber of Commerce, Lahore, December 15, 2022

¹⁸ Liu Xiangfeng, “SME Development in China: A Policy Perspective on SME Industrial Clustering,” 2008, https://www.eria.org/SME%20Development%20in%20China_A%20Policy%20Perspective%20on%20SME%20Industrial%20Clustering.pdf.

¹⁹ Government of Pakistan, *Pakistan Economic Survey 2021-22*, 2021. https://www.finance.gov.pk/survey/chapters_21/PES_2020_21.pdf

Policy Unawareness and Inadequate Representation

During fieldwork, it was discovered that many interviewees were unaware of the policy even though they were important stakeholders and members of associations. Either they had no idea or they claimed that the policy did not cater to them. The association members of both PAAPAM and PASPIDA claimed that they do send policy recommendations but never see these reflected in the policy²⁰. PAAPAM is still working to make amendments to the current policy as it is not for the benefit of the auto parts manufacturers.

Instead, the policy council is a gazetted committee which does not represent the whole sector as small manufacturers have minimal representation and their concerns are not properly voiced. As an interviewee suggested:

“If they reach us (the SME sector), our recommendations will help as the entire SME sector is crucial for the local industry.”²¹

Policy Exploitation and Under Invoicing:

Interviewees claimed that there are a lot of instances when the policy is exploited. An example is of engine localization. The OEMs enjoy duty waivers while earning large revenues through imports. For instance, a member of the PASPIDA stated that

“There is a policy for SMEs (Deletion) that takes the road towards localization. Like Suzuki, it happens in all countries and Pakistan that after some time, they move towards the localization-deletion program. When they launch a new model or car, if they launch it on 100 % import; in 3 to 4 years, they will move for localization of about 60%. But they don't do that. They instead play a trick as they change the headlights after 6 months and launch a new model rather than going for the deletion program.

The auto companies have made subsidiaries, which

import for them and put in vehicles, even though these parts are available in the local industry. If these imports are banned then the local industry will improve to match the standards. The large-scale assemblers create hurdles by themselves. They have created a disguised monopoly, as each company has its subsidiaries abroad from whom they import. They can also buy from the local manufacturers which would reduce costs.”²²

Another common phenomenon in the sector is the exploitation of Free Trade Agreements, as an interviewee suggests

“The manufacturers who import from China have a 5% duty but under FTA, what they do instead is to import (show or route it) from Sri Lanka to Pakistan at 3% duty (as the duty from Sri Lanka is 3%) and sell the part in the local market as a locally manufactured part.”²³

The Afghan-Transit Trade is another example that hurts the local sector. Exports by the domestic sector come back to the country because of the country's policies. For example, a truck that is exported (by Pakistan) comes back into the country in different pieces (mostly re-imported in parts), and these parts are mostly used for replacement,²⁴ (sold in Bara or black market) worsening the aftermarket.

The fieldwork also highlighted many instances of smuggling and under-invoicing affecting the local industry. The smuggled and under-invoiced products are much cheaper, which make it harder for the local manufacturer to survive in the after-market. Multiple vehicle parts, particularly gearboxes, are imported into Pakistan across the Wagah-Attari border.²⁵ The Afghan Transit Trade (ATT) route and Dubai are also utilized to bring Indian and other car parts to Pakistan.²⁶ Tyres, in particular, are handled informally via the ATT route, with an annual turnover of roughly \$243 million.²⁷

²⁰ Service provider and Association members

²¹ APM-3, interview by author, Lahore, October 11, 2022

²² Association Member-PASPIDA, interview by author, PASPIDA-Lahore office, October 11, 2022.

²³ Ibid.

²⁴ Association Member-PAAPAM, interview by author, PAAPAM office Lahore, December 20, 2022

²⁵ Viqar Ahmed and Samavia Batool, “India-Pakistan Trade: Perspectives from the Automobile Sector in Pakistan,” in India-Pakistan Trade Normalisation, ed. Nisha Tanejal Taneja and Isha Dayal (Singapore: Springer Verlag, 2017), 129–69; Association Member-PAAPAM, interview by author, PAAPAM office Lahore, December 20, 2022

²⁶ Ibid.

²⁷ Ibid.

Conclusion and Policy Recommendations

The study concludes that the sector's uncompetitive is a result of an inadequate policy framework and the lack of proper implementation. Although the argument of infant industry has often been used for the auto sector, it has done much harm to both small and medium-scale manufacturing. OEMs have benefited from these policies as only low-value added parts have been localized, while the high-value parts continue to be imported. The overall sector remains uncompetitive in terms of cost, price, and technology which results in low exports. The auto-parts sub-sector remains an area whose optimal potential for Pakistan is yet to be tapped.

The study makes the following recommendations:

Develop an Auto-parts Sub-sector Policy: There is a need for a sub-sector specific policy as current policies focus on the overall automotive sector with minimal focus on the parts sub-sector. A sub-sector specific policy which voices the concerns of stakeholders, can address existing issues ranging from technology, investments, skills, productivity to creating a road map for the auto-parts sub-sector.

Develop Strategy for Technology Up-gradation and Value Addition: Technology is a major aspect for the future progress of the parts sub-sector in terms of fostering innovation and inducing value addition beyond the current production of low value-added volumes. But the sub-sector alone cannot acquire technology and utilize it. Public Private Partnerships can play a vital role in technology transfer and up-gradation of the domestic industry as localization thus far has been a result of this.

Devise a Comprehensive Plan for Auto Fares Participation: Auto fares are important for the export potential of the sector. Stalls range from \$1,500-\$3000 depending upon the size, in addition to transportation costs and other expenses. While large-scale manufacturers can bear this cost, SMEs do not have this capacity even if their products are up to the mark. Thus, the government needs to devise a comprehensive plan for sending local manufacturers to the fares that is consistent with the gestation period of the sub-sector.

Develop Data Dashboard: The auto-parts sub-sector requires data and statistics about the market size of a particular part, quality standards, and relevant manufacturer information. The associations and government need to collaboratively build an integrated and comprehensive database and dashboard for a better-informed policy, planning, research & development and skills needs.



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