2019

COMPETITION ASSESSMENT OF THE TEA INDUSTRY IN PAKISTAN

Please share your comments with:

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COMPETITION COMMISSION OF PAKISTAN

Abbreviations

AJK	Azad Jammu and Kashmir
APTTA	Afghan Pakistan Transit Trade Agreement
CCP	Competition Commission of Pakistan
FATA	Federally Administered Tribal Areas
FAO	Food and Agriculture Organization
GST	General Sales Tax
HHI	Herfindahl–Hirschman Index
KPK	Khyber Pakhtunkhwa
NIC	National Identity Card
NTHRI	National Tea and High Value Research Institute
NTRS	National Tea Research Station
NWFP	Northwestern Frontier Province
PARC	Pakistan Agricultural Research Council
SRO	Statutory Regulatory Order
SBP	State Bank of Pakistan
ZTBL	Zarai Taraqiati Bank Limited

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EXECUTIVE SUMMARY

Pakistan has a tradition of tea consumption, which is closely associated with hospitality in the society. A cup of tea in the morning and evening is a part of Pakistanis' routine life. Pakistan is amongst the major importers of tea, the industry depends entirely on imported tea, with a negligible quantity of tea is produced domestically. In 2014, the long established culture of having tea 'any time - anywhere' accorded Pakistan the status of being the second largest importer of tea, after the Russian Federation.[1]

Tea is a declared essential commodity, therefore, the Competition Commission of Pakistan (CCP) chose the 'Tea Industry in Pakistan' for a competition assessment. This Report, while providing a profile of the industry, focuses on an array of competition issues including market development through tea cultivation in the country, and market dynamics affecting tea prices.

Black tea accounts for around 75% of global tea production.[2] In 2017-18, Pakistan imported black tea from 17 countries.[3] The imported tea is blended to produce various varieties to suit consumers' preferences, and then either packaged or sold in loose form for consumption. Within the branded packaged tea industry, there are only a few major players: Tapal, Unilever and Vital. About 80% of the formal sector market is accounted for by two major companies: Tapal and Unilever, with Tapal taking the lead with a market share of about 45 to 47%.[4] The Herfindahl-Hirschman Index (HHI) index for measuring concentration is 3886, which indicates that the industry is highly concentrated.[5] However, the concentration *per se* is not an indicator of abuse of dominance, yet it points towards influence in the market.

A major challenge faced by the tea industry in Pakistan is smuggling. Under the agreement for transit trade, Afghan imports land at Karachi port, which are then dispatched for

[1] Pakistan Tea Association.
[2] http://agritrade.cta.int/Agriculture/Commodities/Tea/Tea-Trade-issues-for-the-ACP
[3] Pakistan Tea Association. http://www.pakistanteaassociation.com/statistics.html
[4] Pakistan Tea Association.
[5] HHI is a standard measure to assess market concentration. It is calculated by squaring the market share of each firm competing in a market, and then summing the resulting numbers.

Afghanistan. However, instead of entering Afghanistan or even after its entry in Afghanistan, the tea is brought back to Pakistan. This smuggled tea is then sold in the local market along with the legally imported tea. The import cost[6] of tea imported for Pakistan is estimated to be around 32% greater than tea imported for Afghanistan due to the various taxes paid by domestic importers. Due to the cost difference, legally imported tea cannot effectively compete with smuggled tea. The Authority dealing with transit trade highlights that there are no scanners for containers on Afghan border for transit trade, to confirm if the same things are entering Afghanistan that were received in Karachi.

In 2012, the government reduced sales tax from 16% to 5% in an effort to reduce smuggling. This initiative was reversed within 8 months, without allowing for sufficient time to be impactful to curb smuggling. In our view, a combination of tax cuts and enforcement measures are needed to effectively reduce smuggling and to ensure a level playing field in the tea industry.

The report also reviews the history of tea production in the country. The attempts to domestically produce tea started in 1958 but these were not followed up as production in the then East Pakistan (now Bangladesh) met the demand. Efforts were reinitiated later; but Pakistan's tea production remained negligible. Based on our discussions with industry sources and experts at the National Tea and High Value Crops Research Institute (NTHRI), the tea cultivation is successful in Pakistan. Pakistan exported black tea processed at NTHRI during current spring season (1 ton) and green tea (2.5 tons) to Royal world Co. Akasaka, Tokyo, Japan. However, the two major challenges to domestic tea production on commercial basis are:

i. Lack of incentives for farmers to produce tea for a very concentrated buyer's market. The only possible buyers for tea leaves are NTHRI and Unilever. If these buyers cannot purchase their crop, the farmers have no other buyer.

[6] Cost of imported merchandise at the port, including taxes.

ii. The crop has a long germination time (4-5 years), which later produces a harvest for almost a 100 years. Investors need resources, especially land, under a long-term contract to make the investment in production and processing feasible. Such a commitment from individual subsistence farmers with small holdings has been difficult to obtain.

NTHRI and industry players are of the view that an incentive package may help attract private companies to invest in tea cultivation in the identified land tract. By giving appropriate incentives like guaranteed land availability, private tea producers may be inclined to invest in tea farming and processing. These measures can help form a tea industry cluster in the area with a comparative advantage in tea production, thus adding to the competition and efficiency. Food and Agriculture Organization of the United Nations (FAO) indicates that tea growing has immense trickle down effects to rural household incomes. For indigenous tea cultivation, the companies will have an advantage of saving on account of transportation cost and royalty payments. Creation of a 'Tea Wing' in the Ministry of Food Security and Research can go a long way to eradicate hurdles in tea cultivation through suitable policy formulation. Expertise for tea cultivation is available in the form of NTHRI, which may be used, and can prove to be cost effective in the long run.

The Report finds that there are prospects for improving competition in the tea market through: fostering market expansion and improving market transparency. The specific concerns include adulteration in the loose/open tea, deceptive marketing when fake tea is sold in branded tea packs, unexplained price increases, and an inadequate implementation of consumer protection framework, particularly in the Federal capital.

1. DEFINITION OF THE 'RELEVANT MARKET'

In order to ensure that the research remains focused on the targeted product, we must define the relevant market. This market is constituted by the product and geographic market.

1.1 Product Market

The product market consists of interchangeable and substitutable products. In our case, we will define the product market to consist of the dried crushed leaves from the tea plant used to make a hot beverage by infusing the black tea leaves in boiling water. A plant namely '*Camellia Sinensis*' produces the buds and leaves, which are commonly known as tea. Though, black and green tea is made from the same plant leaves but they differ in the production process. Black tea results from leaves that are fully oxidized, while green tea leaves are steamed, rolled and dried without any oxidation. This report only covers the 'black tea' segment of the tea industry.

1.2 Geographic Market

The geographic market consists of the area in which the industry supplies the product with homogenous competition conditions that are sufficiently different from conditions in neighboring geographic areas. The population in almost all geographic locations of Pakistan consumes the beverage. Therefore, for our study, we will take Pakistan as the geographic market in order to study the state of competition in the industry.

2. GLOBAL TEA INDUSTRY

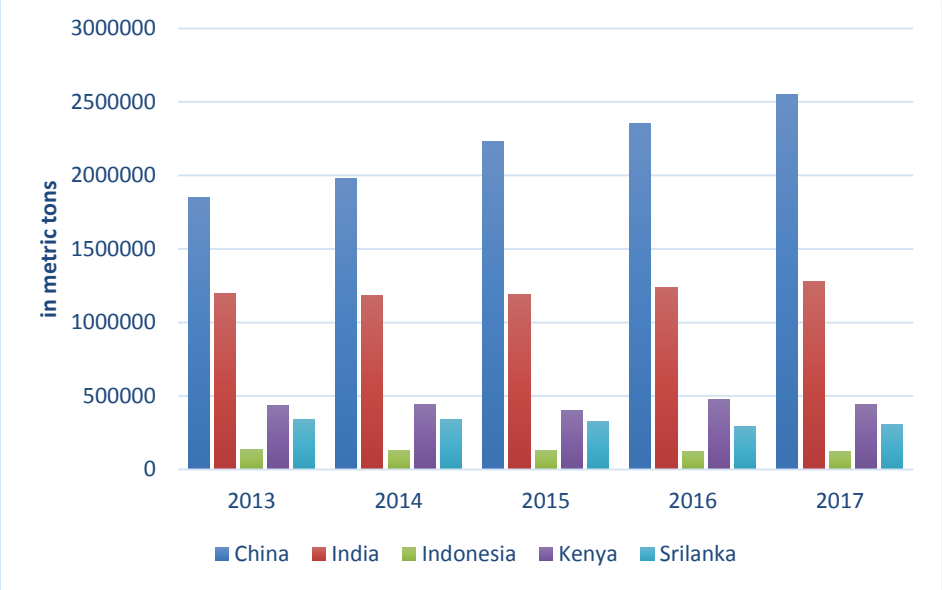
Pakistan's tea industry has strong linkages with the global tea industry. Therefore, this section has been devoted to look into the salient features of the international tea industry. Tea is grown in 36 tropical and semi-tropical countries having a broad range of agro-climatic conditions, between 42'N (Georgia) and 35'S latitude (Argentina).

2.1 Production

The main tea producing countries are:

i. Asia: Bangladesh, China, India, Indonesia, Sri Lanka, Viet Nam and others.
ii. Africa: Burundi, Kenya, Malawi, Rwanda, Tanzania, Uganda, Zimbabwe and others.
iii. South America: Argentina, Brazil and others
iv. Near East: Iran and Turkey.

Figure 1: Rank of Tea Producing Countries (2013-17)



Source: Supplement of Annual ITC Bulletin of Statistics – 2015 and 2017

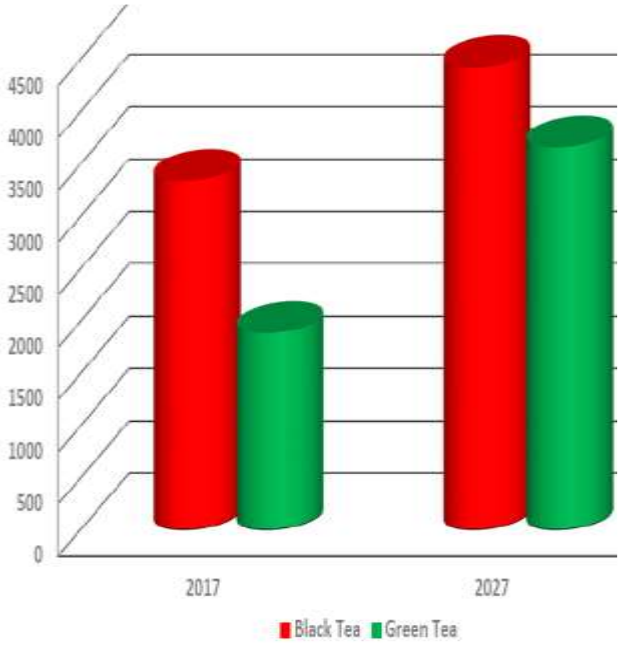
The global tea production including black, green, instant and others, is estimated to have increased by 4.4% per annum in the last decade at 5.73 million tonnes in 2016 (Table 2). China remained the main contributor, where production more than doubled from 1.17 million tonnes in 2007 to 2.44 million tonnes in 2016. China has a share of 42.6 percent in world tea production. India is the second largest producer with an output of 2.44 million tonnes in 2016. Production increased to a record high of 1.27 million tonnes, due to favourable weather conditions. Output in the two largest exporting countries, Kenya and Sri Lanka, reached 475 300 tonnes and 295 300 tonnes, respectively. Production in Kenya increased by 18 percent, while in Sri Lanka it declined by 11 percent. The tea industry in Sri Lanka showed its greatest year-on-year crop shortfall due to severe weather conditions, coupled with government restrictions on fertilizer subsidies. However, the declines in 2015 and 2016, recovered in 2017.

Table 1: Global Tea Production

Countries / Regions	PRODUCTION			
	Estimated 2017	Projected 2027	Growth Rates 2008/2017	2018/2027
	Tons		Percent per year	
WORLD	**3333316**	**4420015**	**3.1**	**2.2**
Africa				
Kenya	439850	605915	3.4	2.7
Malawi	43127	42833	-1.5	-0.3
Zimbabwe	8500	9848	0.7	1.4
Rwanda	24000	30942	2.1	2.5
South Africa	2400	5177	4.2	7.6
Uganda	61411	82426	2.6	2.6
Tanzania United Rep	34000	42770	0.5	2.3
Other	42715	53448	2.1	2.1
Latin America and Caribbean				
Argentina	79000	100782	-0.4	2.2
Brazil	7000	7009	-2.0	-0.1
Other	9710	11228	1.7	1.2
Near East				
Iran, Islamic Republic of	26000	36430	-5.0	3.4
Turkey	310500	429308	4.9	3.2
Far East				
India	1260000	1617871	3.4	1.4
Sri Lanka	305000	370379	0.0	1.6
China	310000	554331	19.1	5.6
Vietnam	86000	100564	-3.7	1.3
Bangladesh	78659	96696	3.6	1.9
Malaysia	13000	10850	2.2	-1.8
Nepal	24264	29309	5.2	1.8
Indonesia	110195	108673	-1.7	-0.6
Other	42870	50064	1.4	1.3
CIS				
Russian Federation	3800	4349	2.7	1.2
Other CIS	4500	12416	1.1	10.1
Oceania	**6800**	**6382**	**-0.8**	**-0.7**

Source: FAO, 2018

Figure 2: Actual and Projected Production of Tea (000 tonnes)



Source: FAO, 2018

At the world level, black tea production increased annually by 3 percent. Robust demand and associated high prices stimulated substantial supply increases over the past decade, resulting in significant growth in domestic consumption and trade. Export earnings at the global level increased by 75 percent over the 10 years, from USD 3.12 billion in 2007 to USD 5.46 billion in 2016, contributing to improved rural incomes and household food security in tea producing countries.

2.2 Tea Exports

World tea exports increased annually by 1.4 percent over the last decade to reach 1.75 million tonnes in 2016, underpinned by larger shipments from Kenya, with exports reaching a record level of 436 924 tonnes in 2016, a 16 percent increase from 2015. However, India achieved the highest tea exports in 2017, after 36 years, thus hitting the record levels registered in 1981.

Table 2: Tea Exports in 2017 (US$)

Rank	Exporter	Export Value	Share (%)
1	China	1.6 billion	20.6
2	Sri Lanka	1.5 billion	19.3
3	Kenya	1.4 billion	18.2
4	India	591.2 million	7.5
5	United Arab Emirates	286.8 million	3.7
6	Germany	245.2 million	3.1
7	Poland	189 million	2.4
8	United Kingdom	137.7 million	1.8
9	United States	136.1 million	1.7
10	Japan	129.9 million	1.7

Source: http://www.worldstopexports.com/tea-exports-by-country/

The other countries having a share of more than 1% include Japan: $129.9 million (1.7%), Vietnam: $123.7 million (1.6%), Indonesia: $114.2 million (1.5%), Netherlands: $100.5 million (1.3%), Argentina: $95.6 million (1.2%), and Russia: $92.3 million (1.2%). The top 15 countries shipped 86.7% of global tea exports in 2017 by value. Among the above countries, the fastest-growing tea exporters since 2013 were: Japan (86.7%), United States (39.9%), China (29.3%) and Netherlands (22.1%). Those countries that posted declines in their exported tea sales were led by: Vietnam (-46%), India (-27.6%), Indonesia (-27.5%), United Kingdom (-26.1%) and Argentina (-18.2%).

It is interesting to note here the experience of UAE. In 2005, Dubai added tea to its Multi Commodities Centre as half the world's tea sailing past its port. Now, it accounts for 60% global tea re-exports, often after value addition. About 5 million metric tons of tea is traded between producers and consumers. Trade zone permits 100 percent foreign ownership; provides a 50-year exemption from corporate tax, income tax, and tariffs; and permits traders to return to their home countries with capital, profits, and currency. Dubai tea center provides a platform for companies looking to set up in Dubai with

immediate access to a purpose-built infrastructure, business services and a growing community of producers, exporters, traders, and entrepreneurs.

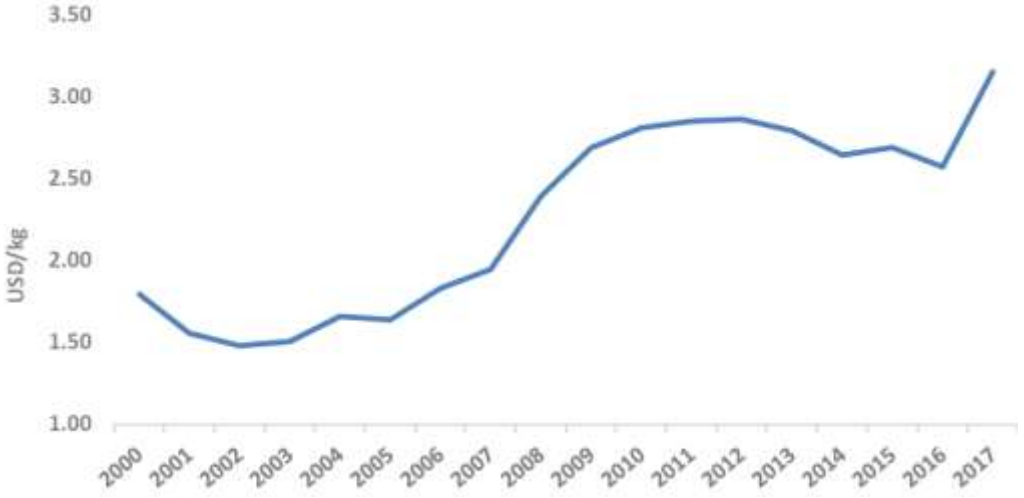
2.3 International Prices

International tea prices are measured by the FAO Tea Composite price (FTCP). This is a weighted average price index for black tea, which includes CTC and Orthodox teas.[7] The FTCP fell by 4.4 percent in 2016, due to continued weakened economic growth rates associated with lower world oil prices. After declining to 2.57 USD per kg in 2016, the FAO Tea Composite Price increased by 22.6% in 2017, to a record high of 3.15 USD per kg. The significant increase is owed to rising domestic and foreign demand and tighter supplies. Prices increased sharply for both, orthodox and CTC teas, in the four major auctions: Calcutta, Cochin, Colombo and Mombasa. (Figure 2).

Since major producers, like China and India, are also among the biggest consumers of tea, less than half of the production is exported. Kenya is one of the world's leading black tea producer and exporter. Due to its comparative advantage, Kenya has achieved a position of strategic importance in the industry. It auctions tea from across the East African region at the weekly Mombasa tea auction, which is one of 11 tea auction sites across the globe, including the rather recently established Dubai Tea Trading Centre. While most of the tea is sold in the international market through auctions, some trading also occurs through private deals. There is no single world price for tea, but prices differ at different auctions, reflecting tea quality and specialization.

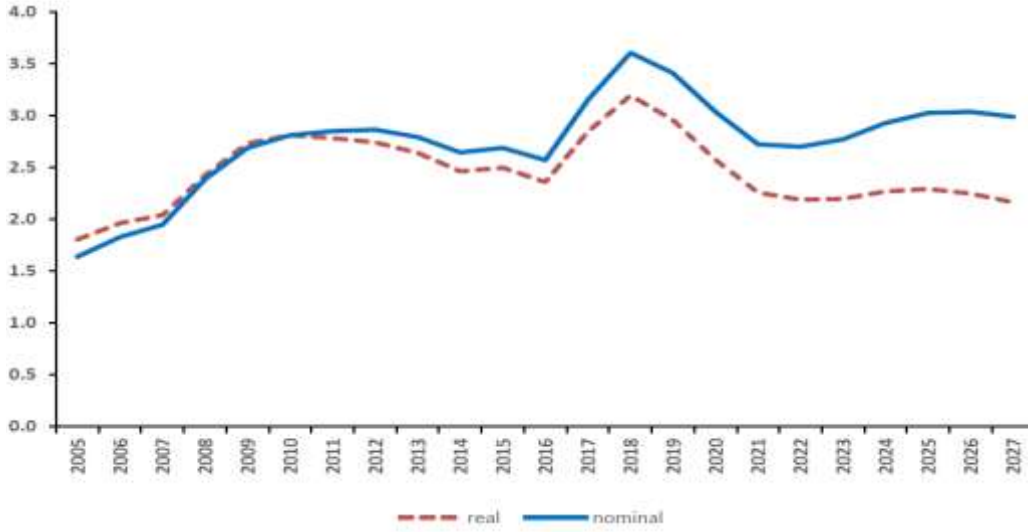
[7] Orthodox Teas are whole leaf teas manufactured using the traditional process of making tea. CTC Teas are made through the Crush, Tear, and Curl (CTC) process of producing a granular leaf particle.

Figure 3: International Tea Price



Source: FAO, 2018

Figure 4 : FAO Tea Prices projections to 2027 (USD/Kg)



Source: FAO, 2018

The review of the world tea market indicates a 2.2 percent increase in trade volumes in 2016, resulting in an estimated 2.8 percent decline in export earnings to USD 5.46 billion at the global level. However, the export revenues contributed significantly to financing the food import bills of tea exporting countries. For example, in Kenya and Sri Lanka export earnings of USD 1.15 billion and USD 1.63 billion, respectively, financed more than 60 percent of Kenya's and 63.8 percent of Sri Lanka's food import bills in 2014.

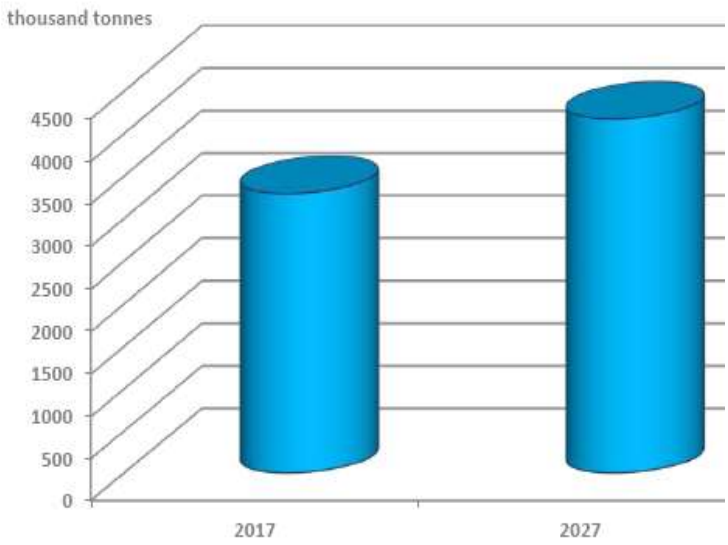
In terms of price developments, the average FAO Composite Price remained firm over the last decade until 2014 when there was a 5.3 percent decline, mainly due to the weakening of CTC tea prices. Prices recovered in 2015, reflecting the recovery in CTC prices offsetting the decline in orthodox teas as imports from the Russian Federation and the Near East fell due to weakened economic growth rates associated with lower world oil prices. In the medium term, the projections suggest that supply and demand of black tea will be in equilibrium in 2027 at a price of USD 3.0 per kg. Prices over the last decade increased from an annual average of USD 2.39 per kg in 2008 to USD 3.15 per kg in 2017, with monthly peaks of USD 3.18 per kg, USD 3.00 per kg and USD 3.26 per kg, reached in September 2009, December 2012 and May 2017, respectively. The projections indicate a decline in nominal terms of 1.4 percent, while in real terms, prices would actually decline by an annual average of 3.6 percent over the next decade.

2.4 Consumption

World tea consumption increased annually by 4.5 percent to 5.5 million tonnes over the decade to 2016 (Table 3). The expansion was derived by growth in per capita income in China, India and other developing and emerging economies. Growth in demand expanded significantly in most of the tea producing countries in Asia, Africa and Latin America. In China, consumption expanded at an annual rate of 10.1 per, reaching 2.1 million tonnes in 2016, or 38.6 percent of world tea consumption. India, with consumption at 1.05 million tonnes, was the second largest tea consumer in 2016, accounting for 19.0 percent of the global total. In importing countries of Europe (except Germany), tea consumption declined as competition from other beverages, particularly bottled water and carbonated drinks, has intensified. While for the Russian Federation, the decline in oil prices negatively impacted tea imports.

Projected Consumption

Figure 5: Black Tea: Actual and Projected Consumption



Major factors contributing to expansion in tea consumption are the growth in per capita income, the increased awareness of the health benefits of tea consumption and the product diversification process attracting more customers in non-traditional segments including young people. The rapid growth of black tea consumption in China is due to the popularity of brick teas, such as *Pu'er*, which are promoted for their health benefits.

FAO has estimated black tea consumption to grow at 2.5 percent annually to reach 4.17 million tonnes in 2027. The strong growth in consumption in producing countries would more than offset projected declines in tea importing countries. The largest expansion within the five top producing countries is expected in China where an annual growth of 5.9 percent is projected over the next 10 years. African countries are expected to show higher growth in their consumption with Rwanda leading the move (9 percent) followed by Uganda (5 percent), Kenya (4.4 percent), Libya (4.4 percent), Morocco (4.2 percent), and Malawi (4.2 percent).

Moderate growth rates ranging between 2 and 3.5 percent are expected in other tea producing countries such as Bangladesh (3.1 percent), India (2.2 percent) and Sri Lanka (3.3 percent). Lower consumption growth rates are expected in western countries with UK consumption projected to be negative as black tea struggles to maintain consumers' interest amid growing competition from other drinks including coffee. Only Germany (1.4 percent) and Poland (1.3 percent), followed by the Netherlands and France (both at 0.6

percent) are expected to have consumption growth rates higher than the region's average of 0.2 percent.

Table 3: World Tea Consumption

Countries / Regions	CONSUMPTION			
	Estimated 2017	Projected 2027	Growth Rates 2008/2017	2018/2027
	Tons		Percent per year	
WORLD	**3290726**	**4168289**	**3.2**	**2.5**
Far East				
Pakistan	172911	250755	7.1	3.9
India	1040000	1264359	3.3	2.2
Sri Lanka	28760	37958	0.7	3.3
China	302353	541310	26.0	5.9
Vietnam	1650	1914	20.6	2.0
Bangladesh	83000	111109	5.5	3.1
Malaysia	34318	46403	4.0	3.1
Nepal	13511	18715	4.7	3.6
Indonesia	52000	64080	5.6	2.7
Other	69907	78382	0.3	1.2
Africa				
Kenya	37630	56567	8.4	4.4
Malawi	13837	20019	22.2	4.2
Morocco	339	503	6.7	4.2
Zimbabwe	2700	3458	-2.2	2.3
Rwanda	2200	5197	34.0	9.0
South Africa	25087	33071	3.1	2.9
Uganda	4433	7200	19.8	5.0
Tanzania United Rep	5000	5733	0.9	1.8
Other	64801	66093	0.1	0.2
Near East				
Iran, Islamic Republic of	81000	85985	-1.5	0.6
Turkey	319621	447406	4.9	3.3
Iraq	39300	41630	-0.5	1.0
Saudi Arabia	31283	41713	2.7	2.9
Syrian Arab Republic	28000	28241	-1.3	0.3
United Arab Emirates	43000	46555	-2.2	0.8
Egypt	84801	89951	0.5	0.7
Libya	14000	21740	5.1	4.4
Sudan	26051	30220	1.0	1.6
Jordan	4979	6918	-2.7	3.3
Israel	1531	2031	3.9	2.9
Other	56278	79212	-3.0	3.3
Latin America and Caribbean				
Argentina	6507	7180	-0.7	1.1
Brazil	7172	7920	3.4	1.0
Other	34735	40621	1.5	2.0
North America				
United States	111756	122222	1.8	0.9
Canada	13776	15216	1.6	1.0
Europe				
EU (28)	188532	193030	-1.4	0.2
UK	105510	103044	-2.1	-0.2
Germany	24952	28725	5.4	1.4
Poland	13882	15803	-2.8	1.3
Netherlands	6670	7071	-7.9	0.6
France	6206	6588	-2.3	0.6
Other EU	23402	23402	0.8	0.0
Other Europe	2633	3013	-1.5	1.4
CIS				
Russian Federation	141192	137812	-1.5	-0.1
Other CIS	70685	77985	-0.6	1.2
Japan	14760	14019	-2.9	-0.2
Oceania	14697	14843	-0.7	0.1

Source: FAO, 2018

The FAO Intergovernmental Group (IGG) has encouraged diversification into other segments of the market, such as organic tea; the health benefits of tea consumption should be used more extensively in promoting consumption. The impact of these recommendations of the IGG can be seen in the local tea market.

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3. Tea Consumption in Pakistan

Several factors affect tea consumption, including the traditional price and income variables and demographics such as age, education, occupation and cultural background. In addition, health has a great influence on tea consumption as people increase their awareness about health impacts of carbonated drinks. Tea is not a perfect substitute but it is being a beneficiary when sales of such beverages decline.

Table 4: Estimated Tea Statistics for Pakistan

	2013	2014	2015	2016	2017
Consumption (Tonnes)	195,364	190,537	212,456	223,843	223,022
Import Quantity (Tonnes)	126,633	137,877	151,861.07	173,749	175,011
Import Value (000 Rs.)	33,567,661	31,200,344	43,939,000	44,815,056	53,022,477
Import Value (000 USD)	329,095	308,456	426,509	427,788	503,155
Smuggled Tea (Tonnes)	68,730	52,660	60,595	50,093	48,012

Source: Industry Association

In Pakistan, the tea consumption remained about 223 thousand tonnes in 2017, which shows an increase of about 14% over the last five years. In the same period, the import quantity and value increased by 40 and 58%, respectively. Therefore, in Pakistan, as elsewhere, the black tea consumption has remained price inelastic. Tea smuggling has been estimated to decline by 30% yet it remains significant at about 22% of the total consumption. Federal Bureau of Revenue (FBR) has estimated smuggled tea to be about

more than 50% of the total tea consumption.[8] This consumption can be divided into two parts: branded packaged tea and loose tea. In the branded segment, there are only a few market players, whereas unbranded segment is composed of numerous players selling loose/open tea.

3.1 Branded Tea Consumption

In Sindh, branded tea is consumed in most of the cities, whereas in the rural areas, both branded and unbranded are equally popular. In Punjab, city dwellers as well as a majority of rural areas are mostly brand loyal, while unbranded tea is only popular in small tea-shops (*Khoka*) and hotels. As far as the tea demand in Pakistan is concerned, there is an opportunity for further market entry that may help smooth price fluctuations and expand the supply to meet growing demand. Our survey indicates that the demand is increasing for high-quality, high-value products, especially in urban areas. The evolving taste of tea demanded also suggests a trend towards higher value-added products, creating an opportunity for innovation and product differentiation through blending varieties to create taste that suits Pakistani consumers.

3.2 Loose Tea Consumption

More than half of the total tea consumption is represented by loose unbranded tea, especially in rural areas. In Khyber Pakhtunkhwa (KPK) and Balochistan, most of the population prefers the unbranded form mainly because of two reasons: firstly, it is relatively cheaper; and secondly, it gives consumers a chance to see and smell what they buy before paying for it.

Within the market for loose tea, there is significant illegal trade. The estimated proportion of smuggled tea in the total tea market volume has remained more or less around 25-30%. This creates a very uneven market for tea suppliers since smuggled tea was at least

[8] https://tribune.com.pk/story/1766456/1-smuggled-goods-account-59-demand-across-major-sectors

30% cheaper than the imported tea due to tax evasion. In 2014, the difference between the price of Tapal and loose tea was Rs 113, which increased to Rs. 276 in 2018. In the same duration, for Lipton the price differential was Rs 150 that increased to Rs. 310. The cost difference increased because of the increase of sales tax to 17% in the budget for the fiscal year 2014.[9] By selling the product at a cheaper rate, the smugglers pulled the sales away from legal importers, who have to sell at a higher rate to cover their costs. Given the high consumption of tea in Pakistan, within which half is represented by loose tea, there is plenty of opportunity for packaging companies to enter the market. However, the uneven playing field is a major challenge that discourages a new entrant. Entry of new competitors strengthens the competition forces, which steer the industry towards greater efficiency. Therefore, the issue of creating a level playing field, through effectively restricting smuggling, is crucial for the development of a competitive formal sector market.

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[9] Ad valorem taxation. Custom duty=10%* Import Price, Sales Tax=17%*(Import Price + Custom duty), Withholding value-added Tax (Import Price+ Custom duty+ Sales Tax) 3%.

4. Market Players in the Branded Tea Industry

There were four main players in the branded and packaged tea industry: Unilever, Tapal, Vital and Tetley. 82% of this market was divided amongst just 2 major players: Unilever and Tapal. In 2014, the Herfindahl–Hirschman Index (HHI), measuring the level of concentration in the industry, was 3646, which in 2018 has increased to 3886, due to the exit of Tetley. This level of concentration is quite high, indicating an oligopolistic market structure. This aspect is deliberated upon in the later part of this section.

4.1 Packaged Tea Suppliers

The following is an overview of the major suppliers of packaged tea:

4.1.1 Tapal Tea (Private) Limited (TTPL)

TTPL was founded by Adam Ali Tapal in 1947; the third-generation CEO Aftab Tapal rejuvenated it in 1977. The company was incorporated in Pakistan on 13 March 1979 as a private limited company under the Companies Act, 1913 (now the Companies Ordinance, 1984). The principal activity of the Company is to blend and sell tea and other related products under the brand name of Tapal. The registered office of Tapal is in Korangi Industrial Area, Karachi. Tapal's deep-rooted culture and core values differentiate it from its competitors. In December 1997. Tapal Tea was the first Pakistani Tea Company that got the ISO-9001 and ISO-9001:2000 certification. Again in December 2000, Tapal acquired the. Major brands include Chenuk Kenya Dust, Danedar, Family Mixture, Mezban Premier Dust, Safari, and Tezdum.

4.1.2 Unilever Pakistan Limited (UPL)

UPL is a limited liability company incorporated in Pakistan that was listed on the Karachi, Islamabad and Lahore stock exchanges (now Pakistan Stock Exchange). Besides tea, it

manufactures and sells home and personal care products, beverages, ice cream and spreads. The registered office of the company is situated at Avari Plaza, Karachi. The company is a subsidiary of Unilever Overseas Holdings Limited, UK, whereas the ultimate parent company is Unilever PLC, UK. Unilever's major brands include Lipton Yellow Label, Brook Bond Supreme, Pearl Dust and Brook Bond A-1 Kark Chai.

4.1.3 Eastern Products (EP)

Vital Tea is a brand of Eastern Products. The company was established in 1991, with its registered office in Bahawalnagar, Punjab. Vital Tea was launched at a small town in Punjab, 'Haroonabad'. Major brands include Vital Tea, Dawn Classical Dust Tea, and Surhan Dust. Vital is marketing tea in various shapes of tea bags.

4.1.4 Who left the market - Tetley Clover (Private) Limited (TCPL)

TCPL was incorporated in Pakistan on July 25, 2003, as a private limited company, under the Companies Ordinance, 1984. The company was formed on May 12, 2003 after a joint venture agreement, signed between Tetley Overseas Holdings Limited[10], United Kingdom (TOHL), and Siza Services (Private) Limited (SSPL), a Lakson Group Company, wherein the said companies agreed to participate and invest equally in the equity of the joint venture. The company was engaged in the import, blending, packaging and marketing of the "Tetley Tea". Tetley's major brands included Josh Dust, Strong and Tetley Gold.

The company left Pakistani market on account of several marketing related issues. These include name and packaging problem, where the Pakistani consumers could not familiarize well with the name. The packing was in purple colour against popular golden, brown or yellow shades for teas. The advertisements could not make their impact due to unclear slogan i.e. '*pehley ankhon sey pee, saanson sey pee, phir honton sey pee to janat mili'.* This was in contrast to the other brands, such as Tapal uses 'family' concept, showing family members bonding. Lipton caters the youth and teenage segment. Tetley,

[10] Tata Global Beverages Limited (formerly Tata Tea Limited) an Indian multinational acquired the Tetley Group (based in the United Kingdom) in 2000.

therefore, having a tea bag segment could not sustain also due to its higher price and distribution system failure.

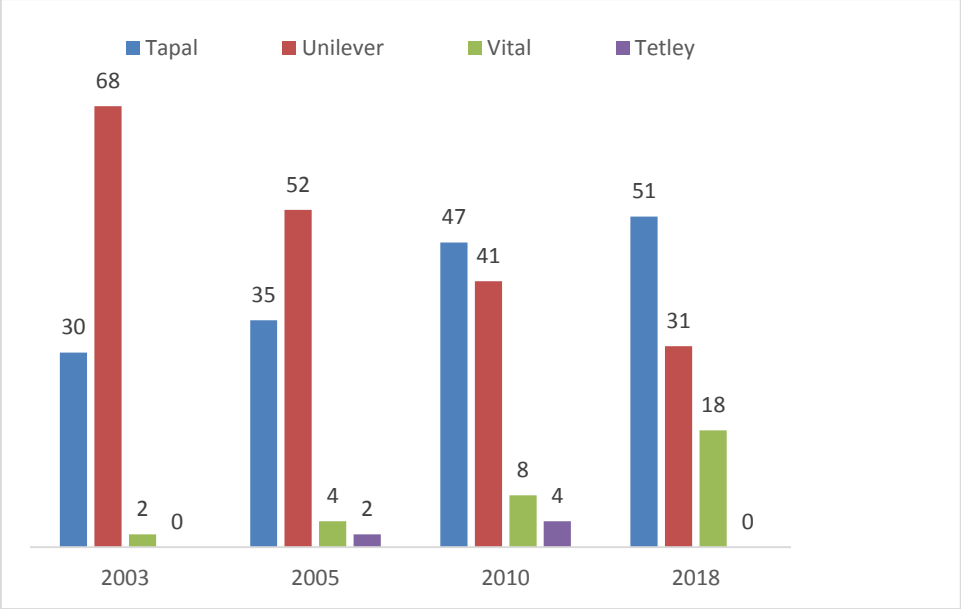
4.2 Pakistan Tea Association

Pakistan Tea Association is an important stakeholder and plays an important role in the tea industry. The association represents more than one hundred and fifty tea importers and blenders. The members meet periodically to discuss challenges faced by the industry and possible solutions. The association actively lobbies with the government for more favorable policies for the tea industry.

4.3 Market Shares

During 2012 to 2017, the tea market saw a gradual change in the market shares. Tapal Tea continued to lead the market, with a 47% share in 2014, which was previously noted to have a share of 48%. In 2018, it successfully captured more than 50% of the market. Tapal is followed by Unilever (31%) and Vital Tea (18%). In 2003, the share of the Unilever was as high as 68% which declined subsequently. Tetley Clover (4%) lost its share in this duration and exit the market. Tetley Clover invested in expanding manufacturing and distribution in Pakistan, especially in urban areas; however, a number of its brands were withdrawn from the market in 2012-13, leaving only three brands catering to consumers, mostly in Sindh and Punjab. Figure 6 shows the estimated market shares.

Figure 6: Percentage Distribution of Estimated Market Shares

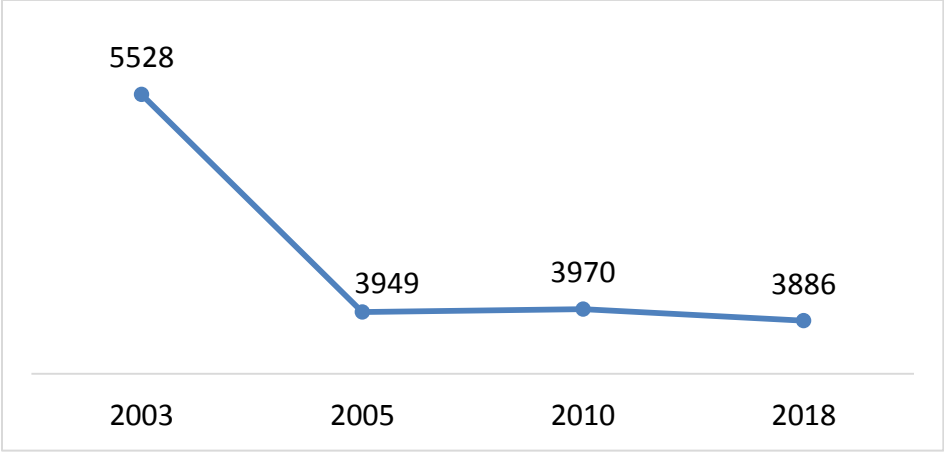


Source: Pakistan Tea Association

4.4. Concentration level in the industry

The Herfindahl-Hirschman Index (HHI) measures the size of firms in relation to the industry. This economic concept is widely applied in competition law, as it indicates the level of competition in the market. The index ranges from 0 (perfect competition) to 10,000 points (single firm monopoly).

Figure 7: Concentration Level in the Tea Industry - HHI



Source: Based on market research

A market is considered to be concentrated if the value of HHI is greater than 1,800. As such, the industry was highly concentrated in 2003 with HHI of 5528. Afterwards, the HHI kept on declining, as Unilever kept on reducing its market share, and introduction of Tetley in Pakistan. In 2010, Tetley acquired 4% market share in the Pakistani industry. In 2018, the HHI reached to 3886. The trend shows that the industry is highly concentrated, which gives market power to the existing players. However, it should be kept in mind that the successful exercise of market power depends on a number of factors besides the market share or concentration. For instance, in the case of tea industry, the ability to abuse market power is restrained by a large informal sector. Consumers particularly those having less loyalty to the premium brands can switch to cheaper available open tea.

5. Price Trends

Generally, the tea prices are higher in Pakistan than in the neighboring countries such as India, Sri Lanka and Bangladesh, who are tea producers as well.[11] Since tea is a highly import oriented industry, the price of the product is influenced by international prices, taxes, and currency value. The correlation between the selling price of branded tea in Pakistan relative to the international price and exchange rate explains the simultaneous price changes by the branded tea companies. This correlation may be more evident by observing the wholesale price of the product, as brands usually try to keep their prices stable by absorbing some of the fluctuation. Our working shows that Tapal and Lipton absorbed the fluctuations in the import price and the exchange rate much better than the Vital and Tetley (which left later on). It has been observed that the prices went up because of the increase in dollar exchange rate only in August 2015, when the exchange rate increased by Rs2.34. consequently, price of branded tea increased by 9%. The increase and decrease in the prices is because of the competitor's prices, as is the case in most oligopolistic markets. Companies have to maintain it as the option of switching is there. Brand loyalty is something that keep these companies keep on running. During the survey, the urban consumers indicate inelastic demand for value added product (s) such as tea bags.

However, the price comparison in Table 1 shows that Lipton already priced its products higher as compared to Tapal and the loose tea. Hence, Lipton did not have to increase the price whenever there was a compulsion to do so for others. It also appears that Tapal was able to capture a larger market share as compared to Lipton owing to its pricing strategy, the last row in the following Table is for reference here. The Table also shows that the price differential between Lipton and Tapal has narrowed down over the years.

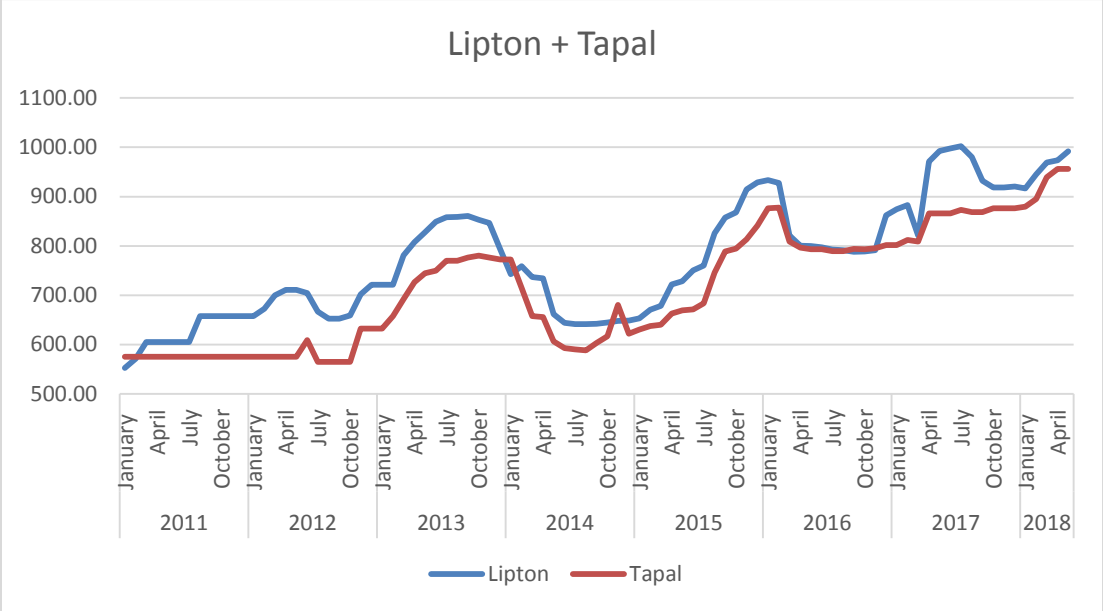
[11] For instance, at the end of FY12, the per kg price of tea in Islamabad was Rs. 710 compared to Rs. 544 in New Delhi, Rs. 363 in Dhaka, Rs. 425 in Colombo and Rs. 469 in Kabul. http://www.finance.gov.pk/survey/chapter_12/07-Inflation.pdf.

Table 5: Tea Prices from 2014-2018

	2014			2015			2016			2017			2018		
Months	**Tapal**	**Lipton**	**Loose**	**Tapal**	**Lipton**	**Loose**	**Tapal**	**Lipton**	**Loose**	**Tapal**	**Lipton**	**Loose**	**Tapal**	**Lipton**	**Loose**
January	772	742	556	630	653	537	876	933	636	802	874	610	880	917	634
February	715	759	541	637	671	531	878	927	629	812	883	622	895	945	638
March	658	737	541	640	678	537	809	821	605	809	821	605	939	969	651
April	656	734	537	663	722	543	797	800	599	866	971	638	956	974	662
May	606	662	521	669	729	547	794	800	600	866	993	644	956	992	663
June	593	644	518	671	751	554	794	797	595	866	997	645	967	1000	664
July	590	641	518	683	760	560	790	792	597	873	1002	646	960	1011	672
August	588	641	517	746	825	585	790	791	599	868	980	645	790	791	599
September	603	642	526	789	858	602	794	788	599	869	932	642	969	1015	672
October	617	644	529	795	868	610	794	789	597	876	919	643	975	1015	676
November	680	648	493	813	915	622	795	792	601	876	919	644	979	1025	678
December	622	648	544	842	929	632	802	862	602	876	921	644			
Yearly Avg.	**642**	**679**	**528**	**715**	**780**	**572**	**809**	**824**	**605**	**855**	**934**	**636**	**933**	**968**	**655**

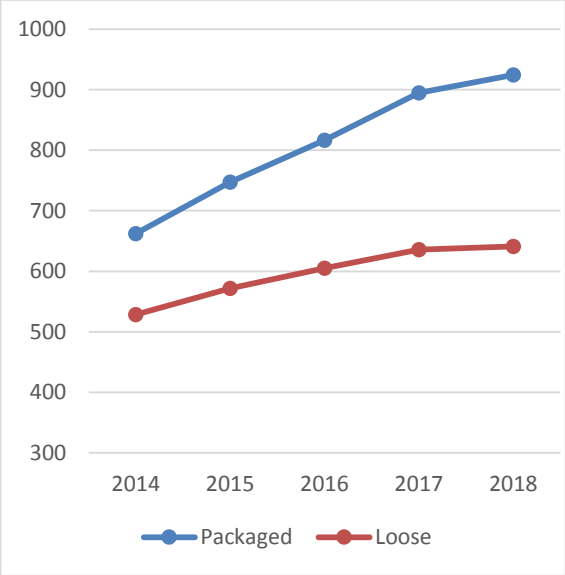
Source: Pakistan Bureau of Statistics - Monthly Bulletin of Statistics

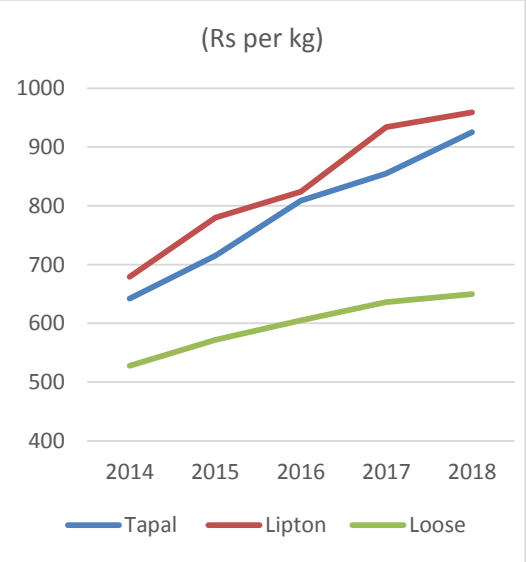
Figure 8: Tea Prices of Lipton and Tapal (Rs/kg)



Source: Pakistan Bureau of Statistics

Figure 9: Packaged and Loose Tea - Price Comparison





Source: Pakistan Bureau of Statistics

According to the Pakistan Bureau of Statistics, the average price of loose tea was Rs. 528/kg during 2014 that increased to Rs. 650/kg in 2018. On the other hand, the packaged tea price was Rs662/kg in 2014, which increased to Rs. 924/kg in 2018. It shows that the price of loose tea increased by 23% whereas that of the packaged tea increased by 43%. Price of Tapal increased by 44% and that of Lipton by 41%. This depicts the impact of higher concentration level and marketing. From the above data, it appears that there is a widening gap between the prices of loose and branded tea. Price for loose tea also increased in this duration but at a slower rate. However, we have no evidence of any collusion or cartel between branded tea marketing companies to charge higher prices. As a strategy, Tapal has managed to capture greater market share and then has raised price over the years. Tea of every kind is easily available and no shortage of the commodity was noted during the survey.

5.1 Statistical Analysis for Tea Prices in Pakistan:

In order to see as to how international developments affect tea prices in Pakistan, the prices of packaged tea and loose tea have been taken as dependent variables (Y), and Kenya tea auction prices (in PKR) and US$ exchange rate as independent variables (X). To estimate the coefficients of independent variables econometric technique Ordinary Least Square (OLS) has been applied. For this analysis, the data is taken for the year 2011-2017 from Pakistan Bureau of Statistics and Tea board of Kenya.

No.	Variable (Y)	Variable (X)	Coefficient	T-value	P-value
1.	Packaged tea price (PKR/kg)	Kenya Tea Price	2.02	4.86	0.005
2.	Packaged tea price (PKR/kg)	USD exchange rate	13.12	3.64	0.02
3.	Loose tea price (PKR/kg)	Kenya Tea Price	1.15	8.20	0.0004
4.	Loose tea price (PKR/kg)	USD-exchange rate	5.61	3.10	0.03

According to the results, if Kenya tea auction price increases by Re.1, the price of packaged tea will increase by Rs2.02. It appears from the data that high demand in winter season might be the reason for some price increases. Moreover, domestic tea prices also increased due to the hike in Kenya tea prices during the last few years.[12] Companies' behavior to increase prices is not justified at some other points in time, when world tea prices were declining. In 2017, price of Kenya tea increased, which lead packaged tea price to increase by Rs 78.

The above results indicate that Re1 increase in the US $ will lead to an increase of Rs13 in packaged tea price. Rise of dollar exchange rate from Rs 86 to Rs 105 could be the reason behind this price increase. Furthermore, if there is an increase of Re1 in Kenya tea auction price, the price of loose tea will increase by Rs1.15. Likewise, if there is an increase of one unit in the dollar rate, the price of loose tea will increase by Rs5.60, which is less than half of the packaged tea price increase.

[12] See, for instance: 'Tea prices raised by up to Rs100 a kilo', March 12, 2018, available at: https://www.dawn.com/news/1394645, and https://www.thenews.com.pk/print/70946-tea-price-rises-up-to-rs856-per-kg

6. Tea Trade

According to FAO, Pakistan is amongst the top 7 countries, where tea consumption has increased significantly. Pakistan recorded a massive increase of 36 percent in per capita consumption of tea from 2007 to 2016. The annual per capita tea consumption in the world is 0.75 kg. Whereas, Pakistan's per capita tea consumption remains about 1.01 kg per annum,[13] almost all of which is imported (Table 6). The period of 2014-2018 represents an estimated import growth of 40%, which is very high.[14] Pakistan's exports represented a negligible value, compared to its imports. The exports were driven by Tapal, which blended various imports and then exported its branded blends. Also, Pakistan exported black tea processed at NTHRI during current spring season (1 ton) and green tea (2.5 tons) to Royal world Co. Akasaka, Tokyo, Japan.

Table 6: Total Import in $/kg

	2013	2014	2015	2016	2017
Kenya	2.98	2.51	3.17	2.67	3.16
India	1.73	1.31	1.33	1.37	1.49
Rwanda	2.71	2.32	2.85	2.45	3.06
Tanzania	2.49	1.89	1.72	2.00	2.01
Burundi	2.65	2.37	3.19	2.29	2.85
Vietnam	1.38	1.48	1.21	1.13	1.23
China	0.95	0.89	0.90	0.72	0.66
Indonesia	2.34	2.07	2.15	2.37	2.51
Others	2.47	1.56	2.14	1.43	1.57

Source: Pakistan Tea Association

[13] http://en.wikipedia.org/wiki/List_of_countries_by_tea_consumption_per_capita
[14] Pakistan Economic Survey 2014 and 2018

One of the factors determining the international competitiveness of an industry is the demand conditions that it faces. If an industry is challenged by consumers having sophisticated demand, this serves as a stimulus for further innovation and improvement to satisfy this demand. Pakistan's own large consumer market allows for companies to perfect their product offerings for the domestic demand. The expertise built in this process can be used to expand further beyond the country, where the companies can also compete fairly in the absence of smuggling.

Table 7: Statistics of Major Tea Auctions in US$/Kg

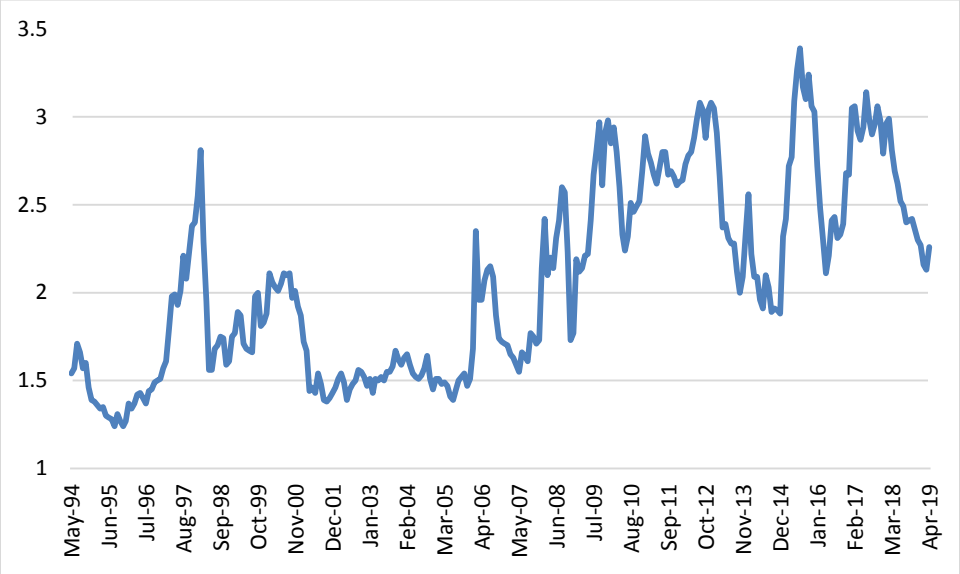
Auction Center	2013	2014	2015	2016
Chitagong	2.72	2.19	2.41	2.55
Cochin	1.94	1.66	1.55	1.74
Colombo	3.44	3.56	2.99	3.22
Guwahati	2.27	2.32	2.16	2.05
Jakarta	1.98	1.66	1.56	1.62
Kolkata	2.72	2.65	2.47	2.41
Limbe	1.82	1.43	1.56	1.55
Mombasa	2.41	2.03	2.73	2.29
Source: Computed from ITC website				

Table 8: Kenya Tea Auction Prices (USD/kg)

2013-14	2014-15	2015-16	2016-17
2.24	3.56	2.69	3.81
2.20	3.14	2.47	3.72
2.23	2.91	2.38	3.62
2.38	3.08	2.64	3.56
2.57	2.96	2.87	3.83
2.49	2.70	3.20	3.69
2.46	2.43	3.44	3.37
2.35	2.43	3.54	3.29
2.22	2.56	3.92	3.05
2.31	2.33	3.71	2.98
2.48	2.36	3.87	2.76
2.56	2.32	4.03	2.80
Average=2.37	**2.73**	**3.23**	**3.37**

Source: https://ycharts.com/indicators/kenya_tea_auction_price

Figure 10: Trend in Mombasa/Nairobi Tea Prices (USD/kg)



Source: https://www.indexmundi.com/commodities/?commodity=tea&months=300

Pakistan imports black tea from several countries, the most important of which are Kenya, India, Sri Lanka, Burundi and Rwanda. Kenya alone supplies more than half of the black tea imported in Pakistan annually.[15] The trend in auction prices is shown in figure No. 10 from 1994 onward. About 40% of Kenya's tea exports are shipped to Pakistan. As per the Kenya's export data, in 2018, Pakistan imported 178 million Kgs. from Kenya at a cost of US$550 million.[16]

Given its high dependence on imports, prices in Pakistan are highly exposed to the fluctuations in international supply, especially since almost half of its imports are from Kenya. Any fluctuation in the supply of tea from Kenya due to political reasons or weather conditions affects prices in Pakistan. While traders do substitute Kenyan tea with that from India and Indonesia, the quality of the tea acquired from these sources is considered inferior to that of Kenya, making it difficult to replace a particular variety with a substitute.

[15] http://www.pakistanteaassociation.com/statistics.html
[16] At the exchange rate of Kenyan Shilling to US$.

The limited substitutability due to difference in taste explains why certain types are favored by certain countries: for example, the Russians and former Soviet republics favor Indian and Sri Lankan tea. The consumers in the UK and Pakistan prefer Kenyan tea.[17] Another reason for Pakistani importers' preference for Kenyan tea is the supply of bulk tea with limited value addition that makes it a cost-effective option. In view of this preference, any disruption in the supply of Kenyan tea results in squeezing the margins of suppliers and making the local prices volatile.

6.1 Factors Affecting Imports

An examination of trend demonstrates the impact of various factors on the import of tea in Pakistan. Accordingly, a 1% change in GDP, population growth, and import duty would change tea import by 1.16%, 1.18% and -0.01%, respectively. Another interesting observation is the 1.29% increase in imports as a result of a 1% increase in consumption. In the absence of any significant export of tea blends from Pakistan, this outcome seems strange; however, it may be explained due to the relative difference in tea quantities in the data for consumption and imports. The consumption data included the tea that is supplied through smuggling while the import data does not. As a result, the quantity consumed is more than the import volume, even though imports are the only legal channel for available tea. Since the model does not distinguish consumption of legal versus smuggled tea, the smaller quantities of import show a higher percentage change compared to bigger quantities of consumption. The absence of any significant legal exports or trends of smuggling of tea out of the country reinforce this view. The output of this model indicates the existence of a parallel market along with legally imported tea that is serving the tea demand. Therefore, long-term sustainability of the industry requires that the smuggled tea be brought into the folds of legal trade.[18]

[17] http://southasiainvestor.blogspot.com/2009/12/tea-can-become-economic-stimulant-in.html

[18] 'Import elasticity of tea: a case of Pakistan', by Rana Ejaz Ali Khan and Tanveer Hussain. This study conducted by the Department of Economics, Islamia University does not look into the impact of exchange rate variation on tea imports. Available at: http://mpra.ub.uni-muenchen.de/34793/1/MPRA_paper_34793.pdf

6.2 Tea Smuggling

A major threat to the tea trade is smuggling. Under the Afghan Pakistan Transit Trade Agreement (APTTA), Afghanistan's tea import lands at Pakistan's port. Since this tea is meant to cross the border and enter Afghani markets, no taxes are collected from these imports. The product then leaves the port, but instead of crossing the border, it pours back into the Pakistani market, particularly into the towns of the province of Khyber Pakhtunkhwa (KPK). The Afghan imports submit a bank guarantee to pay any applicable taxes on the product, if there is evidence that it has not crossed the border. However, even after crossing the border, the border's porous nature allows the product to be transported back and sold at a lower price in Pakistani markets.[19] Such an arrangement creates the opportunity for corruption and is harder to control.

Figure 11: Tea imports under ATTA/APTTA in Packages exceeding three Kgs.

Note: HS Code 90240 Black Tea, the value of imports through transit trade has been highlighted in blue, and exports to Afghanistan in pink.
Source: Pakistan Business Council, 2016

Table 9: Value of Tea Imports

APTTA operational

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
ATTA/APTTA (USD M)	32.21	27.00	43.26	64.83	15.16	136.23	128.19	207.66	113.14	104.79
Pakistan's Imports (USD M)	221.01	196.73	229.66	221.64	298.49	341.50	354.24	313.15	319.19	449.11

Source: Pakistan Business Council, 2016

[19] http://www.nttfc.org/reports/APTTA-Final-Signed%2028102010.pdf

Afghanistan is a country of green tea drinkers but from 2011 onwards, the black tea has remained one of the top imports under APTTA. There seems to be substance in allegations of black tea smuggling through APTTA. It is interesting to note here that till 2011 i.e. when APTTA was implemented, the value of black tea import was significantly less than the international prices and Pakistan's import price. The price of black tea imports under APTTA was a bit more than the price quoted by trading partners for exports to Afghanistan, even then it was 18% less than Pakistan's import price. This shows the element of under- invoicing in imports.

Figure 12: Black Tea Imports under ATTA/APTTA in Packages not exceeding 3 kgs.

Note: HS Code 90230
Source: Pakistan Business Council, 2016

Black tea is among the top imports of Afghanistan via APTTA. Most of the tea imported via APTTA is black tea in packets exceeding 3 kg. Though, the import quantity of black tea under this HS Code is not significant for Pakistan, the price differential, between the per kg cost quoted by Afghan importers, the per kg cost quoted by international exporters to Afghanistan, and the per kg cost of Pakistan's imports, was quite significant in 2015.

NATO related cargo is scanned for security reasons at Chaman and Torkham borders. However, at present for transit trade commercial cargo, there are no scanners at the border. Container scanners can prove to be an essential enforcement tool in the long-term that discourage the illegal trade. Under the UN conventions, Pakistan cannot determine or influence the quantity of tea to be imported by Afghanistan. However, under the national economic interest clause, the other contracting party can be sensitized

through formal complaint by the Foreign Office. The role of the Ministry of Commerce is central here. In other case, if the cost of legal tea is brought down enough to become equal to the cost of smuggled tea, the illegal business would become unprofitable and the practice may be eliminated without significant enforcement costs.

Table 10: Legal Imports vs. Smuggled Tea

	2008	2009	2010	2011	2012	2013	2014
Legal Imports	96,237	84,745	104,768	122,530	126,796	145,688	156,702
Estimated Smuggled Tea*	44,300	52,982	63,565	51,081	60,714	59,763	58,337
Total Tea in the market (Tonnes)	140,537	137,727	168,333	173,611	187,509	205,451	215,039
Smuggled as a percentage of total	32	38	38	29	32	29	27

Source: Based on data provided by the Pakistan Tea Association

* Authentic data on tea smuggling is not available.

Legal imports are subject to the following taxes:[20]

- Port and clearing charges =9%
- Sales tax =17%
- Custom duty =13%
- Withholding value-added tax =3%[21]
- Additional sales tax = 0.5% on commercial importers

Based on the above, the cost for legal imports is higher than the smuggled tea.[22] A price difference is a significant competitive disadvantage to honest importers.

[20] For various types of taxes, the source is FBR.

[21] According to PTA, for industry the rate is 5%.

[22] This differential can be explained by following the calculation: (import price*custom duty)= 110% import price. Calculating further: (Import price*custom duty)+[(import price*custom duty)*sales tax]= 127%

In addition to distorting the market by offering lower prices, smuggling also contributes to increasing the import price for honest importers. During the bidding process, a legal importer would quote a bid after accounting for tax payable and, thus calculating the final sale price that a particular tea can be sold at in the domestic market. Since a smuggler does not need to add taxes to the price, a smuggler can quote a higher price and thus not only out-bid the honest importer, but effectively push up the price of tea at the auction, as a result hurting end consumers.

Smuggled tea is sold in the cities in open sacks, which can be easily adulterated. Gram husk, dyed saw dust and wood shavings are used for adulteration. On the one hand, smuggling is affecting government revenue at the customs stage, and on the other, it is threatening the health of the population with products that can be harmful to health. The exchequer loses about billions annually due to the smuggling of tea.[23]

The government of Pakistan, once in 1996 and then again in 2000, prepared a negative list of products that were not to be traded under ATTA, which included products that did not have much consumption in Afghanistan and were likely to be smuggled back into Pakistan. While reviewing this list in 2004, the ban on black tea was removed, along with 13 other products.[24] This action needs to be reviewed, given the current circumstances. The terms of the agreement should be used to address the problems it has caused in the form of smuggling.

Currently, the Afghan imports have an advantage over Pakistan's legal imports due to the fact that they are not required to pay any taxes on landing. The product imported for Afghanistan leaves the port without paying any of the taxes that are collected from local imports, but ends up being sold in the same local market along with legal imports. The

import price. Next calculation involves: [(import price*custom duty)*sales price]+ [(import price*custom duty)*sales price]*withholding value-added tax = 131.4% import price. This gives us: Cost addition= after-tax value-import price= 131.4% import price-100% import price= 31.4% import price

[23] http://weeklypulse.org/details.aspx?contentID=69&storylist=16

[24] http://www.dailytimes.com.pk/default.asp?page=story_12-4-2005_pg5_10

cost of tax automatically puts the local importers at a disadvantage compared to the smuggled product.

6.2.1 Curbing Smuggling

Possible solutions to reduce and eliminate smuggling of tea are discussed in the paragraphs below:

6.2.1.1 Decrease cost of legal imports by reducing tax

On the insistence of the tea industry, the government reduced the sales tax applicable to tea from 16% to 5% through SRO 608(I)/2012 on 1st June 2012.[25] Within 9 months, on February 28th 2013, this decision was reversed, and the sales tax rate was brought back to 16% through SRO number 153(I)/2013.[26]

Table 11: Effective Tax Burden at Sales Tax of 17%, 16% and 5%

	Post FY14 Budget	Higher Sales Tax	Lower Sales Tax
Import Price	100	100	100
Custom Duty	*10%*	*10%*	*10%*
After Custom duty price	110	110	110
Sales Tax	*17%*	*16%*	*5%*
After Sales tax price	128.7	127.6	115.5
Withholding value-added tax	*3%*	*3%*	*3%*
After withholding value added tax price	132.56	131.43	118.97
Cost of Taxation	32.56	31.43	18.97

Source: Pakistan Tea Association and FBR for rates of various duties.

While the fall in sales tax did reduce tea prices and curbed smuggling (25% decrease month-on-month in July 2012), it did not solve the problem entirely. The incentive for smuggling increases with increase in international prices of tea or depreciation of the Pakistan Rupee. Due to unfavorable weather in Kenya towards the end of 2012,

[25] http://download1.fbr.gov.pk/SROs/20126218629303608(I)2012.pdf
[26] http://download1.fbr.gov.pk/SROs/2013311335851347 2013SRO153.pdf

international tea prices increased, which greatly limited the benefit of tax reduction in eliminating smuggling.[27]

6.2.1.2 Reduce the impact of international prices and exchange rate on smuggling by using a combination of low sales tax and absolute taxation per unit sold.

The major reason for high taxation of this product is the need for revenue by the government. While high taxation allows greater revenue collection on legal trade, it creates an opportunity for creation of an illegal, untaxed trade, which reduces the volumes of the taxed tea. As smuggling drives legal imports out of business, it not only hurts the consumers who may be supplied low quality product but also causes losses to the government. The government needs to take serious steps to curb this smuggling to give the industry a level playing field to compete on. Another possibility, which can be explored, is the introduction of absolute taxation on each unit of tea sold. This way, the tax cost of legal tea will not be influenced by exchange rate or international price fluctuations.[28] As a result of less volatility of legal trade, the profit margins of smuggling may be reduced.

[27] http://www.brecorder.com/agriculture-a-allied/183/1232625/

[28] Presently, the taxes that the government collects from tea sales e.g. sales tax, import duty, etc. are levied ad-valorem i.e. on the value, in percentage terms.

Table 12: Estimated Tax Revenue Lost due to Smuggling

	A	B	C	D	E	F	G
Months in 2012	Smuggling (Tonnes)	Price (Rs./Tonne)	Smuggle product Value (Mln Rs.= A*B)	Loss of Custom's Duty (Mln Rs.=C*10%)	Loss of Sales Tax (Mln Rs.= (C+D)*ST16%)	Loss of withholding value-added Tax (Mln Rs.= (C+D+E)*3%)	Total Loss (Rs. In Mln)
Mar	2,632	236,670	622.96	62.3	109.64	21.59	193.52
Apr	8,060	252,550	2,035.49	203.55	358.25	70.53	632.32
May	4,921	238,410	1,173.32	117.33	206.5	40.66	364.49
Jun	4,101	266,030	1,090.87	109.09	60	37.8	206.88
Jul	4,190	263,320	1,103.43	110.34	60.69	38.23	209.27
Aug	8,173	249,590	2,039.91	203.99	112.2	70.68	386.87
Sep	5,198	285,710	1,485.23	148.52	81.69	51.46	281.67
Oct	3,185	295,540	941.29	94.13	51.77	32.62	178.52
Nov	5,655	278,870	1,577.04	157.7	86.74	54.64	299.09
Dec	5,349	277,530	1,484.62	148.46	81.65	51.44	281.56

Source: Pakistan Tea Association[29]

Table 13: Estimated Tax Revenue Lost due to Smuggling in 2016-17 & 2018

NET KGS ATTA (M.Tons)	**NET KGS 80% ATT**	**US$ *3.10**	**40% DUTY EXP**	**Pak Rs. *103.30**
	ATT 2016			
62616583	50,093,266	155,289,126	62,115,650	6,416,546,680
	ATT 2017			
	NET KGS 80% ATT	US$ *3.10	40% DUTY EXP	Pak Rs. *107
60014671	48,011,737	148,836,384	59,534,553	6,370,197,217
	ATT 2018			
	NET KGS 80% ATT	US$ *3.10	40% DUTY EXP	Pak Rs. *122
63896331	51,117,065	158,462,901	69,723,676	8,506,288,506

[29] ITC Booklet on Smuggled Tea. http://www.inttea.com/

The above table shows that the approximate revenue lost due to smuggling comes out to be huge. These figures are indicative at best, as exact data on the quantity and value of smuggled tea is not available.[30] The taxes and duties on legal imports are:

- Port clearing charges = 9% of value of import, paid at the time of import
- Customs duty =11%, paid at the time of import
- Withholding tax = 5.5% for filer 9% on non-filer on the value of import (paid at the time of import)
- Value added tax = 3% paid at the time of import
- Regulatory duty = 1% paid at the time of import
- Sales tax = 17% (at the time of sale in Pakistan)

An interesting example of eliminating tea smuggling can be found in the history of the UK. Until 1780, smuggling was so widespread in the UK that virtually all the tea consumed was smuggled. The conditions for smuggling were perfect because of high custom duties applied in the UK. The East India Company was the monopoly supplier of legal tea; however, the cheap availability of smuggled tea forced it to dump its surplus in American markets. It was finally acknowledged that the only way to reduce smuggling was to make tea cheaper by reducing applicable duties. So the East India Company, through its powerful allies in the British Parliament, lobbied for the duty to be lowered. The Commutation Act of 1784 reduced the tax on tea from 119% to 12.5%, rendering the smuggling of tea unprofitable. As the smuggling trade became unfeasible, the previously smuggled quantities of tea came under the tax net so that even with the reduced rate of tax, the amount of revenue collected from tea was soon restored.[31]

In the case of Pakistan, tax evasion is another challenge faced by this industry. The major tea companies in the industry forwarded a recommendation to the Customs Authorities,

[30] To estimate loss on account of smuggling for the year 2013 and 2014, Kenya auction price without transportation cost has been used, which gives minimum estimated loss.

[31] http://www.tea.co.uk/tea-smuggling.

proposing that a fixed minimum price be set for every exporting country on which tax due would be calculated. Even if tea was procured at a lower price, the tax would be calculated on the fixed minimum price. And if the import price was higher, the tax would be calculated on the higher price. The justification of this proposal was to ease documentation and reduce false declaration, as the tax would be calculated on a known fixed price.

At present, the tax calculation is based on the monthly average price of tea from each particular source garden or each particular variety. Each country has a number of tea gardens and each garden produces a number of tea types based on processing. Pakistan Tea Association shares the average monthly prices to be used for the tax calculation on its website. This price may not necessarily be the one at which the tea was bought. The average price is used to ease documentation and calculation of taxes due. It is alleged that this system is exploited by importers by making false declarations about the quality of tea and, thus, the applicable price for tax calculation.

While the proposed system of fixed minimum price may overtax low cost tea, it will contribute to reducing tax evasion due to under-invoicing. Since the tax calculation will depend on the source country, checking for tax evasion may become easier. The mechanism for calculation of this minimum price and the frequency of its issue is, however, vulnerable to manipulation and may create opportunity for collusion. A very low fixed minimum price would be ineffective to discourage under-invoicing and a very high price could increase the cost of import. To avoid any manipulation of this price, a formula determining the minimum fixed price could be agreed upon by all stakeholders.

7. Tea Production in Pakistan

Tea is a cash crop and a labour intensive activity, which can boost farm income by 4 to 6 times. This would not only improve socio-economic condition of the people, but also save foreign currency by reducing the import of this product.[32]

7.1 Tea Growing Initiatives

The first tea growing experiments were initiated in the then West Pakistan (presently Pakistan) in village Baffa (district Mansehra, KPK) under the auspices of Pakistan Tea Board in 1958. These efforts were not followed up because tea production in the then East Pakistan (now Bangladesh) met the needs of the nation. Subsequently, efforts to grow tea were reinitiated in 1964 at Misriot Dam near Rawalpindi, but due to unfavorable soil and climatic conditions, they could not achieve the desired results. The high import bill of tea for a developing country like Pakistan became a great problem, therefore, soon after the separation of East Pakistan in 1971, a cell of special crops was created in the Ministry of Food and Agriculture, Government of Pakistan, and a project titled "Research and Introduction of Tea in Pakistan" was initiated in 1973-74. Later on, the project was handed over to the Pakistan Agriculture Research Council (PARC), Islamabad. The National Tea Research Station (NTRS) was established in 1986 at Shinkiari, District Mansehra, which was later upgraded to the National Tea Research Institute (NTHRI).

As a result of these efforts, about 60,000 hectare of land was identified to be suitable for tea growing in Mansehra and Swat districts based on topography, soil and climatic. The potential tea growing areas are located in Hazara and Malakand Division in the Khyber Pakhtunkhwa Province (KPK) (Figure 12). In Hazara, the area is located in districts of Mansehra, Battagram and Abbottabad, while in Malakand it is in Swat. These areas are in a close belt nestled in the foothills of the Himalayas in the northeast and Hindu Kush in the northwest at 35^{o} north latitude and between 72-75^{o}

[32]http://www.aup.edu.pk/sj_pdf/THE%20ROLE%20OF%20NTIONAL%20TEA%20RESEARCH%20INSTITTUTE%20IN%20TEA%20PRODUCTION.pdf

east longitudes and are located in these districts at altitudes ranging from 1000-1500 meters above sea level with varying soil pH ranging from 5.6 to 6.5. In the Southern parts of prospective tea growing areas, summer monsoon provides the rainfall in a sub-tropical monsoonal climate, whereas in the Northern parts, there is significant rainfall both in winter and summer, and the climate is continental Mediterranean. The mean annual rainfall is with average of 1000 to 1200 mm at below 1400 m altitude and 1200 to 1400 mm at higher altitudes. The mountains have their own frost pockets and microclimates. The zones below 1500 m elevation is the prospective tea growing areas as they are humid, sub-tropical and the annual rainfall is >1000 mm having average temperature> 10^0C during at least eight months in a year.

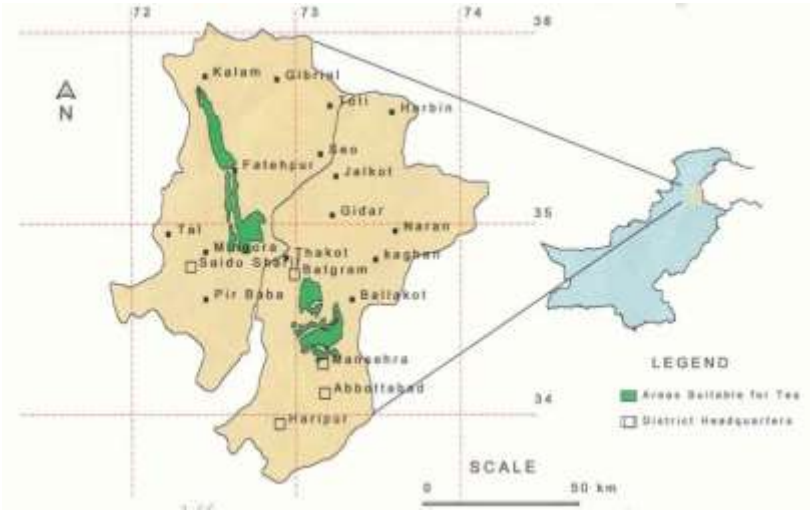
Meanwhile, as part of terms to allow Unilever's acquisition of Brook Bond, the then competition authority in Pakistan, Monopoly Control Authority, required Unilever to invest in tea-growing programs in Pakistan. Unilever Pvt. Ltd. also entered into the tea plantation business in the same area, and established Unilever Tea Experimental Station during 1986. The company planted tea on 1,060 acres (420 ha) on farmers' land and installed a black tea processing plant with a capacity of one ton processed tea in 2001. However, due to climatic and resource availability challenges, Unilever's success in tea farming was limited. While the Government of Pakistan tried to commercialize tea plantation through the Public-Private Sector in prospective tea growing areas, the projects were suspended after the devolution of Ministry of Food and Agriculture.[33]

7.1.1 The Role of National Tea and High Value Research Institute (NTHRI)

NTHRI (previously NTRI) oversees and facilitates the tea plantation operations in Pakistan. It works as an outstation office of Pakistan Agricultural Research Council (PARC), which comes under Ministry of Food Security and Research. PARC has outstations in different areas that specialize in various crops.

[33] http://www.nation.com.pk/pakistan-news-newspaper-daily-english-online/business/15-Apr-2012/planning-commission-s-no-to-funds-for-devolved-projects

Figure 13: Topographic sketch for tea growing area in Pakistan



Source: NTHRI

According to NTHRI, Pakistan has a great potential for profitable investment in the cultivation, processing and marketing of black tea. The samples of black tea cultivated and produced in Pakistan were sent to world-renowned companies, including Tea Craft Company, for conducting quality tests. These companies have found the Pakistani tea to be of a good quality.[34] According to NTHRI, the cost of tea production in Pakistan in 2010 was Rs193.65/kg. The average import price per kg for the same period is Rs 202/kg. This shows that local production of tea might be an investment option, which could substitute the imported tea for a lower price. It could also be offered for export to countries that approve of the taste of domestically produced tea.

Kenya, one of the biggest producers of tea, consumes only 6% of its total production. Due to favorable climatic conditions, it is able to profitably produce and export excess tea to other countries. Pakistan has the potential for tea production that can contribute to the economy by import substitution or exports, once it has achieved economies of scale. At current estimates, the tea cultivation can contribute 60 percent of tea import bill towards

[34]http://www.aup.edu.pk/sj_pdf/THE%20ROLE%20OF%20NTIONAL%20TEA%20RESEARCH%20INSTITTUTE%20IN%20TEA%20PRODUCTION.pdf

farm income. At least one third of this, will directly reach to farm labour. Hence, there is potential of providing employment to un-skilled labour. Besides, the establishment of processing factories will also contribute towards industrialization of backward rural areas and provide additional opportunities for industrial employment and downstream business.

A long-term vision and a strategic plan to reach this vision are important to achieve the goal of a profitable tea production. Suitable areas like district Mansehra and Battagram can be made tea-producing clusters to strengthen competitive forces and ensure efficiency. By using the region's comparative advantage in tea production, not only will we be able to improve the socio-economic condition of the population, but we can also diversify our agricultural output. Experts at NTHRI are of the view that after successful tea growing in Pakistan, now constituting a statutory body may be helpful to safeguard interests of tea growers, processors, private investors, and research organizations, as is the practice in other tea producing countries.

7.2 Crop Characteristics

- Tea crops are identified based on three major characteristics: Aroma, Taste and Color. Crops vary in all these characteristics; therefore, tea from a variety of sources is blended to make a variety of mixtures for different consumer preferences. This characteristic serves as a strength for the crop, because even if the crop does not substitute imports in Pakistan, there are markets internationally for which Pakistan can supply its product and earn foreign exchange.
- The crop can be used for both green and black tea production, since the plant is the same and the different products are produced through different ways of processing. This offers wider opportunity for the crop.
- After the initial investment, until the plant matures (4-5 years), the cost of maintenance of the crop decreases. It only requires periodic cutting, pruning and application of fertilizer. Therefore, the initial investment can give returns for almost 120 years.

- A challenge faced by farmers is that due to small holdings, they are unwilling to dedicate land to a tea crop that would take years to mature.
- The tea leaves must reach the processing facility within 4 hours of plucking, thus requiring essential infrastructure close to the farms.
- Since there is not a formal market for the tea crop, the farmers are not certain of being able to sell their product. The only buyers could be NTHRI or Unilever through buy-back agreements, since they are the ones who have processing units in the vicinity.
- Access to power is a major factor influencing the crop processing. The cost of processing also influences the willingness of buyers, adding to the uncertainty of a sale.

7.3 Land

Most of the land suitable for tea plantation is located in Mansehra's hilly terrain, parts of Swat, FATA and AJK. In order to promote tea production, the government has to play a catalytic role by forming facilitating policies. To bring about an increase in tea production, a commercialization project through public-private partnership was initiated. Three major private sector enterprises, M/s Qarshi Foundation, M/s Khawaja Foods Kashmir (Pvt) Ltd. and M/s Neelum Plantation (Pvt.) Ltd., were to participate in the project. The companies signed an MOU with AJK Government on 2nd May 2005, which was followed by the signing of a formal leasehold agreement on 24th May 2007.

The parties in the investor group also met the Government of KPK in March 2007 and agreed to provide 3,000 acres of suitable reserved denuded forestland in district Mansehra. For this project, the Forest Departments in KPK and AJK had to lease out 1,000 acres each to three private companies for tea cultivation. These companies had to provide job, health care and education to local people in their respective areas.[35]

[35] http://dawn.com/2011/08/15/agriculture-and-technology-tea-project-delayed/

The project was an excellent opportunity to transition domestic production from research and pilot phase mode to private sector led commercial production, processing and marketing. According to the plan, the investors would train and encourage local landowners and farmers to set up tea sapling nurseries in their holdings on a guaranteed buy back agreement basis. The investors would also establish tea-processing units after tea plantations were set up in the area at a large scale. These units would buy all the raw green leaf produced by the private farmers in the area. The National Tea Research Institute at Shinkiari (Khyber Pakhtunkhwa) would provide technical knowhow and the group would also start tea research stations in this territory. This project would have profitably utilized denuded forestland and wasteland, while adding more diversity to the agricultural product offering of Pakistan.

In spite of minimal investment from the government, the project could not be launched in KPK due to the refusal of the Forest Department to allow cultivation on its land. The difficulty of acquiring land in KPK stems from the fact that the provincial government offered the Forest Department's land for tea cultivation; however, the Forest Department was unwilling to hand it over to the private sector. This may be due to the forest authorities' own personal interests at stake, like selling the grass, trees, and giving grazing areas to farmers.

The AJK government had also agreed to lease out 3,000 acres of forestland to a group of three companies for 15 years for tea cultivation in the area. The land was to be leased out against Rs 600,000 per annum, while the group of tea plantation would invest about Rs 1.5 billion over the next five years in the AJK, with no financing by the state government.[36] However, even in the AJK, the project could not be executed successfully due to issues in land allocation and security conditions. Consequently, the investors withdrew from the project.

[36] http://www.dailytimes.com.pk/default.asp?page=2010/09/05/story_5-9-2010_pg5_10

With the dissolution of the Ministry of Food and Agriculture, this project was closed. The opportunity of profitable tea cultivation is being wasted due to the inability of the government to provide the resources necessary for cultivation. To make investment in the crop viable, land is a resource that the government must ensure is available to the private sector for the long term. Due to small land holding of individual farmers, obtaining such a guarantee for long-term land availability is not possible, making private investment unfeasible. Unavailability of land at a predictable cost was one of the reasons Tapal pulled out of tea production within a few years. Therefore, without government participation in guaranteeing land availability, especially the culturable wasteland, to the private investor, any growth in tea production will be very difficult.

7.4 Water

NTHRI points towards the need for effective water management in the hilly areas to store winter rains for sprinkling during the drought season. For this purpose, mini dams in potential tea growing areas may be helpful to avoid the chances of water scarcity in warmer season.

7.5 Market

Due to the small volume of tea production, there is no formal tea market. Farmers cannot sell their output to resellers or consumers. They must directly sell it to processors. Currently, there are only two processing plants in the area of production: NTHRI and Unilever. Both operate through buy-back agreements with farmers to purchase their output on pre-determined rates. Such a limited buyer market makes the farmers highly vulnerable to changes in the buying decisions of the buyers, especially in the case of NTHRI, which depends on government funding for its operations. When NTHRI is unable to procure their output due to high processing cost and insufficiency of funds, only Unilever remains for the farmers to sell their product.

For the market to be more competitive, both production and processing capacity should increase. Only if there is sufficient processed output, will there be an incentive to establish

a more formal market for the product. In addition, a formal market will develop because of higher volumes. It is, therefore, important to offer appropriate incentives, and create a long-term plan for the development of the local tea production industry.

7.6 Financing

Funds are critical for tea farming. Tea is a purely commercial crop. Farmers cannot use any of it for their own subsistence; therefore, it is critical for them to have access to buyers willing to whom they can sell at a sufficient profit. Financially weak farmer cannot afford to buy required inputs. The credit, given to the tea-growing farmers of NTHRI, was through Zarai Taraqiati Bank Limited (ZTBL).[37] However, ZTBL has discontinued its supply of credit to tea producers due to insufficient interest of farmers in a crop that has limited sales options.

7.7 Training

The NTHRI trains farmers in nursery development, provides tea plants and guidance for cultivation and evolves technology packages for them. It also gives inputs to farmers and purchases their produce. It aims at self-sufficiency in tea. However, due to a shortage of personnel and absence of extension system, it has limited outreach to farmers. The provincial agriculture department with its staff, resources and outreach capacity could play an active role in tea plantation.[38]

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[37] 'The Role of National Tea Research Institute in Tea Production', Sarhad J. Agric. Vol.25, No.2, 2009.
[38] http://dawn.com/2011/08/15/agriculture-and-technology-tea-project-delayed/

8. International Production Models

8.1 Small Holders

Small holders play an important role in the tea sub-sector worldwide. While most tea producers started with large-scale plantations, small holders are becoming increasingly significant contributors in total tea production. There are more than 400,000 small holders in Sri Lanka who account for 76% of tea production, produced in 64% of the area under tea. In Kenya, an estimated 560,000 small holders account for 62% of total tea production. In India, the world's second largest tea producing country and largest consumer of black tea, an estimated 160,000 small holders account for over 26% of its production.[39]

8.2 Large-Scale Corporate-Estate

The alternative plantation model is of the large-scale corporate-estate with an integrated field and factory operation. This model still accounts for a significant share of production in India, Sri Lanka and Kenya. Contrary to the concept of economies of scale, this is considered a high-cost model. However, the quality of its produce is often considered superior. The smallholder model in India is considered low-cost-low-quality production, catering largely to the lower-end of the domestic market, while in Kenya, the quality of smallholder tea is higher, but productivity of large-scale estates has always been above that of the small holders.

8.3 Options for Pakistan

Small holder production is seen as an increasingly viable production model. There is a trend towards investing in stand-alone factories and sourcing of green leaves requirement by entities in estate sectors, from both smallholders and their own plantations. In the past decade, the two largest blending and marketing companies in

[39] FAO estimates, "Contribution of smallholders to the tea sub-sector and policies required to enhance their livelihood", 2012.

India (Unilever and Tata Tea) left the estate-sector, preferring to buy their input from other producers.[40]

Considering the challenges faced by the public-private partnership large-scale production projects, it may be more feasible for Pakistan to offer incentives to small and medium scale enterprises to enter different stages of the value chain. Setting up small processing plants with the participation of small holders could be more effective in attracting private participation in the industry than large-scale projects that are subject to political hindrances. Small holder participation in processing protects them from exploitation, especially in the absence of regulation. Indonesia and India have dealt with the issue of farmer exploitation by introducing regulations, which determine the relative shares of the smallholder and the private processing factory in the revenue generated from the sale of the *made tea*, based on market prices prevailing in the auction centre/primary market. Government incentives aimed at encouraging smaller investors to set up tea facilities may be useful in adding depth to the market, which may later integrate to widen the scale of the production.

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[40]http://www.fao.org/fileadmin/templates/est/COMM_MARKETS_MONITORING/Tea/Documents/IGG_20/12-4-Smallholders.pdf

9. Barriers to Entry in the Market and Competition Concerns

9.1 Natural Barriers

Differential distribution of required resources like land, water, and climate, give an advantage to certain market players and constitute natural barriers to entry.

9.1.1 Soil and Climatic Conditions

Climate related issues are the most important factors for tea cultivation. Due to climate barriers, tea cultivation is not possible in Punjab and Sindh. The tea crop requires deep, permeable well-drained and acidic soil having a pH ranging from 4.5 to 6.5.[41] It is usually grown on sloping land. However, it can be grown on leveled land with good drainage. The water requirement for tea is comparatively higher than most other crops. For a luxuriant crop, an annual rainfall above 1,000 mm is required, while intermittent rainfall throughout the year greatly enhances its growth and production. Temperature is another important factor for tea cultivation, where optimum temperature for tea growth ranges from 12°C to 30°C. Temperatures below freezing and above 35°C greatly hamper tea growth.

9.1.2 The Socio-economic Conditions

Subsistence farming, surplus funds for investment and social condition of people are the other obstacles to tea production in the region. Most of the people of the area have very small holdings of land, usually in *kanals*, which is one-eighth of an acre. The farmers, therefore, are reluctant to grow tea because it is a long duration crop and takes 7 to 8 years to reach the complete yielding stage. They prefer short duration crops like vegetables, maize, rice, and wheat that provide a quick return to meet their daily life expenditures. Most of the farmers are very poor, while tea requires some investment for

[41] Pervaiz, U., A. Khan, N.M. Khan, M.Z.U. Khan, Ikramulhaq, Q. Khan, M. Idrees, S. Ahmad and Iftikhar Ahmad. 'The Role of National Tea Research Institute in Tea Production'. Sarhad J. Agric. 25(2): 349-353. Available at: http://www.aup.edu.pk/sj_pdf/THE%20ROLE%20OF%20NTIONAL%20TEA%20RESEARCH%20INSTITTUTE%20IN%20TEA%20PRODUCTION.pdf

its cultural practices such as weeding, fertilization and irrigation. Thus, investment on tea and poverty of the farmers is one of the hurdles for tea cultivation in Pakistan. The farmers are unwilling to adopt this long duration crop that occupies fields the whole year. The plant-to-plant and row-to-row distance of the crop does not permit farmers to undertake enough inter-cropping practices, which make them more reluctant to cultivate this crop.[42]

9.2 Strategic Barriers

The distribution network is an important tool that companies use to compete with other firms. Often using anti-competitive practices at this stage, the companies may try to exclude competitors from target markets or limit availability of their brands. One such option can be to limit the market to which a distributor can supply tea and the price at which it supplies. Such practice would be a violation of Section 4 of the Competition Act 2010 ("The Act"). Accordingly, an undertaking cannot enter into an agreement in respect of production, supply, distribution, acquisition or control of goods or the provision of services, which have the object or effect of preventing, restricting or reducing competition within the relevant market. The prohibited agreements include fixing of purchase or selling price, imposing any other restrictive trading conditions about the sale or distribution of goods or provision of services, and dividing or sharing markets for goods or services by territories, volume of sales or purchase by type of goods or services sold or by any other means. While such clauses may limit competition between distributors, they may be justified if the cost of loss of competitive force is less than the efficiency benefit. In such cases, undertakings have to seek an exemption from the CCP under Section 5 of the Act.

Tapal Tea Pvt. Ltd. sought an exemption. The company appoints distributors for specific markets to sell their product at a price determined by the company. By limiting the market and price, the agreement limits competition between different distributors in the relevant

[42] http://www.dailytimes.com.pk/default.asp?page=2010/09/05/story_5-9-2010_pg5_10

market. However, to be able to supply the product to the consumer in a timely and efficient manner, it is essential for the company to be able to operate a systematic distribution network. By limiting the market for a particular distributor, the company ensures timely and continuous supply to all traders at the company's price, proper care of stocks, in time payment to the company, submission of timely orders, claims, and consumer's complains. In this case, the benefits of the restriction seem to outweigh the cost. The company applied for exemption in June 2008, which was renewed subsequently.

9.3 Regulatory or Policy Barriers

There are no barriers on the number or types of companies operating in the industry or any licensing requirement for traders. A trader only needs a national identity card and bank account to be allowed to import tea.

In addition to tariffs, other taxes applicable on tea result in a strong monetary incentive for smuggling in the absence of a transparent enforcement system to ensure that Afghani import do not enter Pakistan. The parallel market of cheaper smuggled product serves as a barrier to entry as well, since legal importers' sale prices become uncompetitive.

9.4 Competition Concerns

In 2012-13, the CCP conducted an inquiry into the price trends in the tea sector. The enquiry concluded that there was no evidence of collusion between companies in this sector. Some of the reasons for this conclusion were the following:

i. In addition to the branded tea suppliers, there are a number of tea importers who are supplying loose tea to consumers at lower prices. Given a large number of suppliers of tea, it is harder for the industry to organize into a cartel and reach an agreement on price fixing, quota allocation or division of market.
ii. Entry barriers to the industry are low due to the simple criteria for eligibility to import tea. Anyone can enter the industry; however, the presence of a parallel

informal market of cheaper smuggled tea does greatly influence the incentive to enter the market.

We are of the view that due to a high demand, the competition in the tea market has remained fierce. The companies in the formal sector face a tough competition as consumers have a choice to switch to unbranded unpackaged loose tea over branded packaged tea. To create brand loyalty, product differentiation and advertising are used. However, price hikes, though may be for short periods, should closely be monitored for possible explanations.

Some incidence of 'deceptive marketing practice' in the form of fake tea packaged as branded tea was found, also some consumers of the loose tea reported adulteration. While adulteration in food products is covered under separate legislation, the deceptive marketing issue needs attention of the CCP. Any case of deceptive marketing can be brought into the knowledge of the CCP by the district food officers, district administration, and food authorities, who deal with the issue at the local level. There is a need to formulate a mechanism of information sharing between the CCP and district administration's functionaries through advocacy and outreach activities of the CCP targeting provincial governments.

Tea of various types and brands is easily available at grocery retailers and wholesalers. No shortages have been reported. As far as future prospects are concerned, based on population and consumption growth, the tea sales are expected to grow by 10-12%. In the branded tea segment, the demand for tea bags is expected to grow by more than 15%.

10. Recommendations

10.1 Controlling Smuggling

Smuggling is the biggest threat faced by the domestic tea industry, causing loss of millions of rupees to the government and forcing legal importers out of business. The government must take firm action to curb the illegal trade. A combination of tax and enforcement tools can be used to control the practice. The incentive to smuggle comes from the difference in taxation on tea imported for Pakistan and that imported for Afghanistan. This difference can be reduced through tariff rationalization by reducing the tax imposed on Pakistani imports, and by increasing the cost of tea landing in Pakistan for Afghanistan. By decreasing cost of legal imports, the smuggling trade can be made unprofitable.

10.1.1 Revisiting Transit Trade Agreement

Under the APTTA, the Afghanistan-bound tea imports land at Pakistan's port. The product leaves the port, but instead of crossing the border, it flows into the Pakistani market, particularly in the towns of Khyber Pakhtunkhwa (KPK). Even if the product crosses the border, its porous nature allows for the product to be transported back, and sold at a lower price in Pakistan. This creates opportunity for corruption and is harder to control. The negative list under the transit trade agreement be revisited to limit imports hurt the domestic market. Use of the transit agreement facility for such products may be prohibited or a limit may be applied on imports volume. Therefore, the CCP may recommend Afghanistan Pakistan Transit Trade Coordination Authority (APTTCA), Ministry of Commerce to take up this matter more effectively with Afghan counterparts, to curtail black tea import that is in excess of Afghan demand. Indeed, under Article 3(2) of the APTTA, 2010 Pakistan can lodge a formal complaint. The State Bank of Pakistan has also recently pointed out the need to put in place an effective control mechanism through a consultative process to curb smuggling in Pakistan under the grab of APTTA. [43]

[43] 'Afghanistan: SBP proposes massive changes in trade regime', 'Business Recorder, 29 July 2019. Available at: https://fp.brecorder.com/2019/07/20190729501128/

10.2 Creation of a Tea Wing

The industry is represented by the Pakistan Tea Association. Since the membership of the association consists mostly of tea traders, it is unable to represent challenges faced by tea producers. Apart from the NTHRI, Unilever is the only company having experience of tea growing in Pakistan, who is a member of the PTA as well. While a tea board existed, it could not play an effective role in the affairs of the industry.[44] The Ministry of National Food Security and Research (MNFSR) may consider creating a 'Tea Wing' to devise policies and program to encourage both production and trade of tea. The need for a statutory organization as highlighted by the NTHRI, could be fulfilled initially by this Wing that may be transformed to a full-fledged Board, if so needed in the long run. The Wing can perform a broad range of functions relating to rendering financial and technical advice for cultivation, manufacture and marketing of tea, particularly, to develop the small growers' model in Pakistan.

10.3 Ensuring Land Availability

In the absence of any interested parties, it is understandable that we did not see a push from the stakeholders for policy making on tea cultivation. However, KPK and AJK governments may tap the potential for employment generation. The commercialization of tea project through public-private partnership should be revisited with federal, provincial and AJK governments ensuring the secure availability of land to potential investors for tea production, and by involving smallholders as key stakeholders in the project.

10.4 Enhancing Competition

The tea industry needs market development and documentation of businesses. The competition in the branded tea market has remained fierce as consumers have a choice to switch to unbranded unpackaged loose tea over branded packaged tea. However, there

[44] http://www.dailytimes.com.pk/default.asp?page=story_24-7-2003_pg5_17

should be well-justified explanations for prices increases. Competition can be enhanced by eliminating the chances for ‘Deceptive marketing’, when fake tea is packaged as branded tea. At a local level, information about deceptive marketing can be gathered from the district food officers, district administration and the Food Authorities, which are responsible to monitor quality and price of commodities in the open market.

COMPETITION CONCERNS AND RECOMMENDATIONS FOR MARKET DEVELOPMENT		RESPONSIBILITY	PRIORITY
1.	***Smuggling causes unfair competition and restricts market development***		
	• A combination of tax and enforcement tools can help control smuggling. By decreasing the cost of legal imports, the smuggling trade can be made less attractive.	Government	High
	• To control selling of Afghanistan-bound tea in Pakistani market – national interest clause in the transit trade agreement may be used to limit the import in excess of Afghan consumption, which hurts the domestic market.	APTTCA, M/O Commerce	High
2.	***Tea Wing***		
	• The task to devise policy and action plan for indigenous production of tea and its trade may be assigned to a 'Tea Wing' created within the MNFS&R.	Government, MNFS&R	Medium
3.	***Ensuring Land Availability***		
	• KPK and AJK* governments may tap the immense potential for employment and income generation through tea cultivation. Commercialization of tea project through public-private partnership should be considered by federal, provincial and AJK governments. Ensuring long term availability of land to potential investors is inevitable for success of tea growing initiative.	Government	Low

Note: * AJK is not covered under the ambit of Competition Act, 2010.

Annexure I

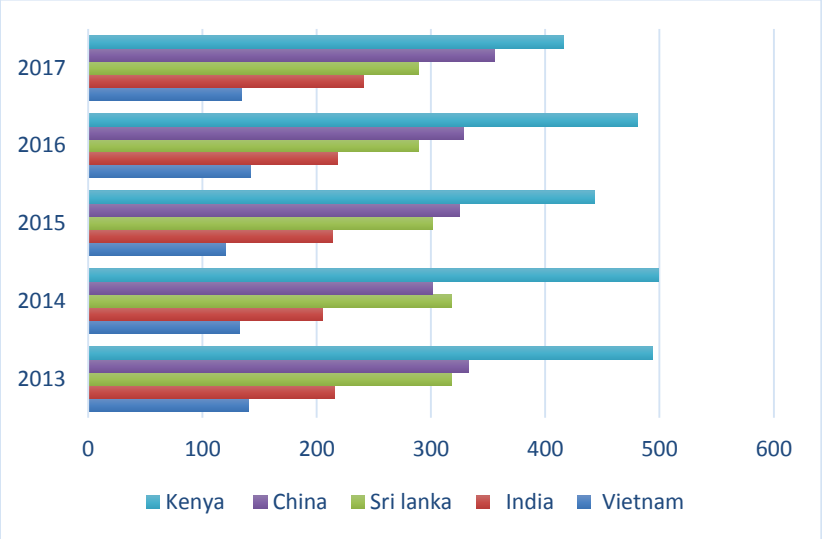
Major Producers - Tea Production Trend (mln kgs)

Country	2013	2014	2015	2016	2017
China	1924	2096	2230	2405	2550
India	1200	1207	1191	1267	1279
Kenya	432	445	399	473	440
Sri Lanka	340	338	329	293	307
Vietnam	180	175	170	180	180

Source: Supplement of Annual ITC Bulletin of Statistics, 2015 and 2017
http://www.fao.org/3/BU642en/bu642en.pdf

Annexure II

Tea Exports Trend (mln kgs)



Source: International Tea Committee

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