Textile Sector Perspective on Budget

The Federal Budget for FY22 was announced on June 11th, 2021. The new economic team has accordingly set goals for the next two years, with an agenda characterized by two points: (i) inflation and (ii) revenue generations to fund social programs for the masses. Out of the current expenditures, the major portion of 72.34% will be spent upon General Public services that include debt repayments, pensions, salaries and perks among other things. 18.2% on Defense, 3.5% on social protection, 2.4% on Public Order & safety, 1.6% on Economic Affairs, 1.2% on Education, 0.5% on Housing, 0.5% on Health, 0.1% on Recreation, Culture & Religion and on last priority only 436 million for pollution control.

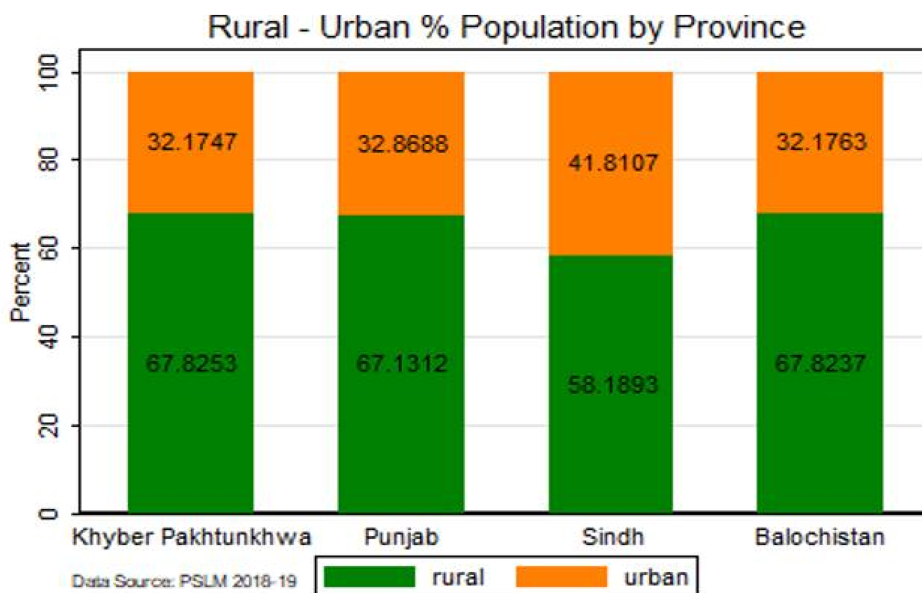
Textile exports have served as the mainstay of the economy, comprising the majority of Pakistan's total exports and generating a substantial amount of revenue in the form of taxes, and foreign exchange support for the Balance of Payments. The TERF scheme has led to a substantial increase in investment levels at a time where capacity was already full, presenting a golden opportunity for expansion. In the sector's recent leap towards capacity development, policy support from the government should play a critical role, as it is imperative to support textiles in order to achieve sustainable export-led economic growth.

Shahid Sattar

Executive Director, APTMA

Eman Ahmed

Economic Analyst, APTMA



The government has, despite challenges, successfully progressed from "recovery to stabilization to sustainable growth" (PIDE). While there remains a need to continue these efforts for sustained growth in the long-term, the debt indicators are improving overall as the current Public Debt-GDP ratio is being sustained at the present level and Debt Service-Revenue ratio is showing a downward trajectory. The government aims to sustain these trends particularly through revenue mobilization, and supporting the export-oriented sectors is one highly effective method of doing so.

There are several positives in this budget, particularly with respect to continuation of duty-free import of cotton, concessional financing under Long Term Financing Facility (LTFF) & Export Finance Scheme (EFS), and bringing retailers into the tax bracket. However, like every year, the budget leaves several pressing issues unaddressed, particularly those aspects which have potential to adversely affect the export-oriented sectors of Pakistan. Exporting sectors have the ability to lift Pakistan out of its debt cycle, and supporting them to remain profitable and productive should be one of the government's primary concerns. Yet issues of custom duties, sales tax, energy and logistics continue to create hurdles for these sectors, thereby contributing to an anti-export bias which has kept Pakistan behind its regional competitors in exports.

First off, the adverse change in customs duties on Polyester / MMF value chain is a matter of concern. The items of direct immediate concern are those that involve polyester yarns and acrylic yarns. In the case of polyester yarn 5509.2200/2100 where the applicable duty was 11% + 2% ADD + 2% a total of 15% R.D. this has now been reduced to 10+2 for a total of 12%, while the duty on PSF remains at 7% despite the textile industry's repeated submissions and reports on the negative fallout of continued protection. There are also antidumping duties of up to 12% which make matters much worse. With these duties in place the textile sector of Pakistan which is already uncompetitive will face additional stress. Meanwhile, in the case of acrylic spun yarns 5509.3100/3200 produced with acrylic staple fibers, the duty is proposed at 0% which is against the basic principle of cascading whereby the duty differential should be a minimum of 5%.

Sales tax rate has been increased to 17% from 10% on both cotton and import of machinery and plant. This increase will unnecessarily increase the quantum of Working Capital required for operations and increase the capital cost on new projects. The point to note on cotton sales tax is that refund can only be cleared on consumption while cotton has to be bought in bulk tying up the Working Capital for a long period of time. The increase in Sales Tax on plant and machinery increases the cost of putting up new plants as the refund cycle of the Sale Tax will have to await commercial operations which in some cases for many years. Sales Tax Refund on import of plant and machinery by operating units is despite the passage of 2 years is still not streamlined as the Faster System rejects any claims above arbitrary percentage which does not take into account the extraordinary high claims in a particular month on account of machinery imports. These changes in Sales Tax regime will have a negative impact on new investment in the sector as funds that could have been spent on plants and machinery will unnecessarily be blocked. The feasibility of new projects in particular will be severely impacted.

Moving forward, a fundamental concern is the need for regionally competitive energy pricing/tariffs. Our country's energy tariffs have not been commensurate with regionally prevailing tariffs, as shown in the table below:

	Classification	Budget Estimate 2020-21	Revised 2020-21	Budget Estimate 2021-22	Growth (%)
A.	Current Revenue Receipts				
	Federal Transfers				
	Revenue Assignment	679	642	798	17
	Straight Transfers	62	57	49	-20
	Grants to offset losses of abolition of OZT-(0.66% of Provincial Share)- (incl. Others)	18	17	21	17
	Total	760	717	869	14
	Provincial Tax Receipts (excluding GST on Services)	128	105	154	20
	Provincial Sales Tax on Services	135	125	150	11

Despite unreliable energy supply and higher tariffs, the textile sector has been operating at full capacity and receiving increased orders, leading to the revival of non-operational units, and the creation of new jobs. Textiles have been heavily supporting the economy, yet the industry's profitability is being hampered by illogical energy tariff hikes and policies. The export-oriented sector has given detailed reasons time and time again for the provision of a fixed electricity tariff at 7.5cents/KWh and $ 6.5 per MMbtu for RLNG/gas across the value chain to ensure competitive export pricing. Competing countries are already poised to combat highly competitive market conditions through cheaper electricity and gas rates. Energy accounts for 35% of conversion costs in the textile value chain and therefore competitive pricing of exports is highly sensitive to energy pricing. Therefore, the provision of regionally competitive energy tariffs is critical, and any deviation from these rates will derail export targets.

The allocation on account of regionally competitive energy tariffs and the differential for domestic tariffs falls short of the amount needed – Rs. 64 billion is necessary as estimated by the Ministry of Energy. The allocation for differential on account of electricity is Rs. 21 Billion whereas the estimated differential at 9$ per KWh will be Rs. 40 Billion. Furthermore, the allocation for differential on account of gas is Rs. 10 Billion while the estimate at current LNG rates is Rs. 29 Billion. It may be clarified that both these allocations are indicative and any shortfall, it is assumed, will be met through supplementary grants. Therefore, continued supply of gas to the textile industry may be ensured for the sector to sustain production to achieve the target of over $20 billion exports next financial year.

IMF has kept Pakistan's economy in a strait jacket and our exports remain limited to intermediate goods, while we remain an importer of oil, edible oil, tea, pulses, machines, raw materials, and even knowledge. At present, remittances are our saving grace when it comes to foreign debt. It is essential to support exporting industries in order to sustainably combat foreign debt, and to enable growth by diversification of our export bundle, expansion into higher value addition, and investment in human capital in order for Pakistan to compete in today's knowledge-based economy.

Considering the rapid expansion being undertaken by the textile sector, whereby the industry is on track to meet next year's target of $20 billion, it is to crucial to acknowledge that this is a substantial increase of $5-6 billion. Such an increase will be accompanied by a pressing rise in requirement for working capital. The manufacturing chain takes around 6 months to export, and without simultaneously increasing working capital to remain at par with the requirements of an expanding sector, progress in the industry will come to a halt. The most efficient way to ensure that working capital needs are met could be by reducing the GST rate down to half, or even better, restoring zero-rating. This will be an instrumental step in Pakistan's journey to meet and exceed the $20 billion export target set for the next year, and for $26 billion by 2023.

An acknowledgment of the critical issues highlighted in this article would not only make the budget's revenue and growth targets achievable, but would additionally keep the expansion of mills on track and generate employment for one and half million people. We request the government's urgent attention for correction of these issues for the continued growth of exports in line with the vision of achieving $20 billion exports next year and growth beyond.