Is devaluation favourable for exporting industries, suppliers?

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LAHORE: Pakistan has emerged as the lowest cost country after abnormal devaluation in the last one year. In fact, its minimum wage of $98 at current dollar value matches that of Bangladesh that increased its minimum wage few months back to $98.

Labour, power, energy, water and steam and diesel costs account for 33 to 45 percent of the total product cost in most of the manufacturing industries. Prior to recent devaluation, Pakistan was already the most competitive country in the region in water, steam and diesel costs.

Its minimum wage at $108 was however 10 percent higher than Bangladesh. After the dollar rate touched Rs152 in the interbank market, even this difference vanished.

While this advantage may not benefit the industries producing products for domestic market, it would be a boon for the exporting industries if they put their act together.

It is pertinent to note that the rates of all imported items have increased much above the rate of devaluation, as the import duty and sales tax on duty paid value of the product has to be incorporated in the cost.

As far as local prices are concerned, the increase is not as sharp and precise as in the rates of imported goods. The devaluation in a way would also provide advantage to the local manufacturer/suppliers over the imported stuff in free and fair trade (minus under-invoicing and smuggling).

Exporters should be in the driving seat, as devaluation has covered all the flaws in government policies, particularly the textile exporters. The devaluation has provided them an opportunity to launch Pakistan as the manufacturing hub of all labour intensive industries. Exports however have disappointed everyone by their lacklustre performance on numerous earlier devaluations in the past nine months. Those remained stagnant even after the government announced subsidy on energy supplies.

This phenomenon should be a source of worry for the economic planners and the exporters as well. It is indeed surprising that our exports were at about the current level or slightly higher when the dollar was traded at Rs108 and our minimum wage was $138 and the gas supplies were irregular and expensive.

It was during that period that around 125 spinning industries (textile was our major export) were closed down. That means a capacity capable of generating $3 billion across the chain was closed.

When exporters sought concessions from the new government, they assured that the closed units would be revived after competitiveness is restored. The News stance has from day one been that the units closed because of obsolete technology would not revive, and that has happened.

The decline in rupee value did improve competitiveness of the operating industries, but that did not increase their capacities. We simply do not have export surplus. We have not added any significant capacity to replace the closed capacities of 125 spinning mills.

It is worth mentioning that most of the current mills are also operating on old and high power consuming technologies, but massive rupee devaluation has more than compensated their inefficiencies.

As the devaluation deepens, it has also started fattening their pockets. They might survive in the midterm, but will have to ultimately wrap up if the technology is not upgraded.

Meanwhile, some larger players have started adding new high tech capacities that would increase export in the next six months. But it will not compensate the capacity lost due to earlier closure of mills.

The surge in export should come from the apparel sector, where the value-addition was highest. It is unfortunate that the apparel sector has not really scaled up.

In the past ten years, successful apparel exporters have enhanced their capacities by buying machines of thousands of closed units. So, the installed capacity has not increased much.

Large-scale upgrade is also needed in the existing readymade garments and knitwear industries. The incentives for upgrade in the textile sector (mark-up subsidy) are meant for the entire value chain.

But, almost the entire amount earmarked for this purpose was consumed by the basic textile industry. This left the small apparel exporters high and dry (banks also prefer clients that invest billions instead of few million).

The government must come up with special allocation for apparel upgrade to facilitate them. Since the sector is labour intensive, it can benefit from the low cost of labour and other inputs to take our exports to the next level.