Textile sector in dire straits

BR epaper.brecorder.com/2019/10/18/18-page/806149-news.html

October 18, 2019

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The textile sector is on the verge of complete standstill due to the worst-ever financial crisis emanating from the imposition of the 17% sales tax, CNIC condition for transactions and high cost of bank borrowing. To further complicate the matter, delay in processing of refund claims has completely blocked the flow of cash within the sector, on top of that, the FBR issued Bonds in lieu of sales tax refunds are nothing more than non-negotiable paper carrying no sovereign guarantee. Given such stark illiquidity in the market and very slim margins in the sector, these imprudent policy measures combined will lead us to a massive de-industrialization, fall in exports, worsened Balance of Payments (BoP) and unmanageable levels of unemployment.

Pakistan's largest manufacturing industry and locally produced cotton which is commonly labeled as "white gold" is subjected to a major collapse after the abolition of SRO 1125-Zero rating and imposition of 10% sales tax on locally produced cotton. Abolition of SRO has created unsustainable discrimination against the domestic industry supplying input goods to exporting units against exporters importing their inputs through DTRE, EOU or Bonds. These schemes allow a registered exporter to import goods without duty and taxes and to purchase zero-rated input goods. This 'discriminatory' treatment between the imported raw materials and locally manufactured similar input goods is resulting in the closure of the local industry while encouraging unnecessary imports.

The 17% Sales Tax regime on exports has increased the cash flow requirement equivalent to additional Rs. 25 to 30 billion per month on $ 1.1 Billion (or Rs 170 Billion) worth of textile exports each month. The laborious system of refunds based on receiving the export proceeds after dispatching the goods makes it difficult for industry to self-finance Rs 180 -Rs 240 billion to continue financing the export requirement. The refinance limit of Rs. 480 billion has already been exhausted, which requires industry to finance Rs. 520 billion through own resources which could very well have gone towards modernization and expansion.

Furthermore, textile industry, despite being efficient and competitive, is losing its own domestic market to the imported textiles that are either grossly under-invoiced or are smuggled into the country. Additionally, the value of textile products dumped in the name of used products is enormous in Pakistan. Pakistan's imports for used clothing are almost 10 times greater than India's.

Moreover, when a company holding a DTRE, Bond or EOU licence needs to buy raw materials like cotton, yarn or greige fabric, if it imports them, it does not have to pay sales tax or duties, whereas, if they buy the same material from domestic industry, it is required to pay 17% GST and wait for its ultimate refund after exports which entails a minimum wait of 9 months. A fair treatment can only be ensured if the entire input chain is subject to the same percentage of sales tax.

Under these circumstances, the domestic industry has no chance to compete with imported raw materials. In the past, since the entire sector was zero rated, domestically produced goods had a commercial edge on imports because of rapid availability and assurance of timely delivery and quality.

Liquidity is the critical factor for every business entity in deciding the ratio of imported and local raw materials. Financial gains promised to change input ratio in favour of imported raw materials having no sales tax on them clearly illustrates the commercial advantage attached to increasing quantum of imported raw material in input mix. No businessman is likely to limit his liquidity in the chain of sales tax refunds on domestic inputs when this can be avoided through cheaper imports.

The new GST rules have distorted the level playing field that was operating and now heavily favors sales tax free imports. This distorted playing field applies to all the raw materials in the textile industry starting from cotton, yarn to greige fabric to PSF etc. In the case of cotton, local phutti prices are already depressed by Rs 300-400/maund. It is feared that the limited demand for domestically produced cotton may lead to a situation where the substantial amount of cotton crop in the fields may not even be picked up.

Currently, cotton is subjected to 3 different types of duty and taxation systems. First of all, if cotton is imported through DTRE and EOU, etc., it is exempted of any duty or tax. Secondly, there is 5% sales tax on direct cotton import without any scheme, thirdly, a 10% sales tax is levied on domestic purchase of cotton. The highest level of taxation on domestic cotton purchases is actively promoting cotton imports over domestic cotton purchase.

The system of having multiple tax rates for similar commodities in identical markets is bound to be abused and will definitely fail. The 17% GST system can only survive if same rate is applied across the system. It appears that the government policies do not take into account the need to develop and support domestic industry and are actively substituting local production with imports.

Similarly, deindustrialization and a massive loss of jobs is bound to occur as the government policies continue to favor imports over domestic production. Under the current circumstances since more inputs will be imported, net exports (difference between exports and inputs) will decline and the balance of payments (BoP) would be adversely affected.

Cotton economy is a major source of revenue for Pakistan. Liquidity and Working capital in business is just live blood in human body. Optimum and appropriate movement of blood through the body is extremely necessary to continue life. Like human blood, the proper circulation of funds (working/circulating capital) is utmost necessary to continue business. The vicious cycle of stuck liquidity is detrimental to the large scale manufacturing sector. Running any businesses is now fraught with uncertainty and as a result, exports are most likely to decline precipitously in future.

Amendments are urgently required in the Sales tax laws and rules so that sales tax is payable on all goods that are imported under any scheme except those that are not manufactured in Pakistan. The refund policy has to ensure refund within 7 days of Goods Declaration (GD) filed with Customs to ensure liquidity of the market and restoration of cash flows to avoid a market crash. The delay in the payments of outstanding dues has precipitated the textile sector to an unsustainable liquidity crisis which will significantly hinder any export growth.

(The views expressed in this article are not necessarily those of the newspaper)