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Dividends of trade war

At times, a kick in the back is a lot more effective than years of rational arguments. And the China-US trade war might be just that.

Imagine a scenario in which instead of a tariff battle the United States and China have increased bilateral trade to new heights. China increases imports from Pakistan and newspaper headlines blare the country's improving export numbers.

But that is not to be. The trade war between economic giants has suppressed the import demand from Pakistan in China. The trend was reflected in trade data.

Trade war impact on yarn

"Pakistan's cotton yarn exports declined 15.4 per cent to \$835.7 million in July-March 2018-19," states the third quarterly report of the State Bank of Pakistan (SBP). Citing Chinese customs data, the report explains that cotton and yarn imports by China dropped by a sizeable 17.2pc last year as part of the trade war with the United States.

'US importers have lost confidence in China, which benefited Vietnam, Cambodia and Bangladesh in a big way,' says a textile industry leader

Since cotton yarn consists of about 44pc of Pakistan's exports to China, the dip exacerbated the current account deficit and contributed in a small measure to the need to approach the International Monetary Fund (IMF) with a begging bowl. However, the trade war's effect of losing out on exports of raw material and intermediate goods may also have created new and more lucrative opportunities.

Silver lining

In the backdrop of the IMF programme and the trade balance pressure, the drop in textile raw material exports to China came at a time when the country could ill-afford it.

However, it has turned into a blessing in disguise.

"In the last three weeks, we have received a lot of inquiries by US retailers," said Pakistan Textile Exporters Association Chairman Khurram Mukhtar. "They have lost confidence in China because of which Vietnam, Cambodia and Bangladesh are the biggest beneficiaries. We have not been able to benefit as much as the other countries have but home and garment sectors within the industry are receiving a boost."

Mr Mukhtar went on to explain that while the impact was not significant in dollar terms because of depreciation, the textile sector's quantum of exports had increased by 32-36pc.

Given the noise created by big businesses because of the hardships attributed to the budget, a question arises whether the sector has the capacity to benefit from available opportunities. In Mr Mukhtar's view, there is still 30pc idle capacity that can be utilised to boost exports by \$2.5-3 billion. However, a cash-flow crunch remains an issue, he added.

His sentiments were echoed by the adviser on commerce and textiles, Abdul Razak Dawood, in a recent interview with Dawn. Mr Dawood said that the slowdown in textile raw material and intermediate exports to China has benefitted Pakistan in a roundabout manner as they are available at a more competitive price for local manufacturers.

Economic gains of value-addition		
	Selling price per quintal (100kg of seed cotton)	Value-added contribution
Raw cotton	Rs3,200	1
YarnRs4,800	1.5	
Grey fabric	Rs7,500	2.25
Garment	Rs25,200	8

Value addition

Though the buzzword 'value-addition' has been in vogue for decades, Pakistan's textile exports lean more towards cotton yarn and woven fabric than apparel.

While teaching a course at the Institute of Business Administration, ex-SBP Governor Salim Raza once shared an illustrative table of price appreciation when seed cotton is processed into a garment.

Though the data in the table is somewhat dated, his argument was that converting cotton into apparel yields the highest factor of value addition. Manufacturing of yarn and grey cloth is highly mechanised and the processes depend on imported machinery. Therefore, it under-contributes to employment and does not allow Pakistan to leverage its low-cost labour.

Thus, the total factor productivity payback of the industry — i.e. net value added — remains low whereas the reliance on imported machinery remains high. Keeping micro-economic jargon aside, it means that Pakistan is using its inputs in the least efficient manner to get the maximum monetary benefit.

Competing with big boys

The European Union and the United States are Pakistan two's main destinations for textile exports. While the GSP Plus covers exports to the European Union, the US preferential tariff regime GSP does not. Any increase in exports to the US market means Pakistan is competing with the big boys on an equal footing.

In the past, industrialists opted the easy way out of supplying raw materials to competing countries rather than investing in value-addition. One garment exporter and member of the Federation of Pakistan Chambers of Commerce and Industry that Dawn talked to said he had wrapped up his business five years ago because he saw the writing on the wall — that the economy was not headed in a direction for his enterprise to remain commercially viable.

However, the trade war may have created the space for the domestic textile sector to revive hope. The mollycoddled local industries have been protected by import substitution policies for decades. Open competition in the global market while facing a tough macro-economic environment at home may let the industry emerge stronger.

Overly optimistic? Possibly. However, the latest export numbers shared by the adviser on commerce indicate a 17pc increase in readymade garments and 16pc increase in home textiles in July over June. Though a month's numbers do not represent a trend, being forced towards finished goods rather than raw materials may nudge the sector towards stronger and more sustainable growth.