Regionally competitive energy tariffs

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Pakistan’s uncompetitive and inefficient energy mix has rendered economic growth elusive and also raised pertinent questions about affordability. Our country’s energy tariffs have not been commensurate with the income levels of the general population or with regionally prevailing tariffs. The regionally competitive energy tariffs that were provided in 2018 to support the textile sector, Pakistan’s largest manufacturing and exporting sector, reaped benefits instantly and led to impressive expansion and growth, both within the industry and for Pakistan’s economy as a whole. The textile sector outperformed competition and expectations during the time of COVID-19 and lockdowns. However, hurdles frequently arise insofar as this sector’s smooth performance is concerned. One such hurdle is the motion to remove regionally competitive energy, a blunder that would sully all past developments and efforts. Providing the sector with an enabling business environment is crucial to maintaining its role as a strong growth stimulus for the economy. Furthermore, the potential for higher value addition at subsequent phases of production enhances the sector’s ability to move Pakistan into tertiary production and industrial growth, but without competitive energy, this will remain a distant dream.

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. In the past, the textile sector commended the Prime Minister for making Pakistan’s energy tariffs competitive with those in Bangladesh and India, but the current rate is 9 cents/Kwh which is well above average of 7 cents in the region.

The government has offered to offset the high energy tariffs with a DLTL package, but this is an unsustainable solution as only direct exporters can benefit from it, whereas 80% of textiles comprise the chain as pictured below (Figure 1). Given the higher energy tariffs of our region, a domestic producer will not opt for local inputs while they can import them cheaply and without duty through DTRE and Bond. This policy, if followed through, will lead to rapid deindustrialization.

So far, the textile sector has managed to meet demands but growth has remained elusive, as high energy tariffs, power shortages, and illogical government policies have kept the sector stagnant. Despite limitations, the sector has performed well during the period of Covid-19 and posted a growth of almost 11 percent in exports during January 2021.

In terms of cost of conversion (where the cost of raw material is subtracted from the total cost of production), energy cost is the leading component, especially in spinning and weaving. Thus, it is pertinent to comprehend the importance and relative share of energy in the conversion cost. Due to a tough competition among regional countries, a minor cost difference in relative terms brings a huge impact in the international market.

Exporters face the brunt of the pressure from high energy tariffs, thereby facing a reduction in market share and leaving Pakistan far behind its regional competitors. This is also one of the prime reasons for the stagnation of exports, a fact which was duly acknowledged by the government when it announced regionally competitive tariffs back in 2018. However, over the last few months, there have been promising levels of export growth and positive impacts on industrial expansion and job creation. Minister for Commerce and Investment Abdul Razak Dawood recently tweeted that the country's exports have crossed the 2-billion mark in four consecutive months. Our exports for Jan 2021 are up by 8% to $ 2.14 billion, compared to $ 1.98 billion in Jan 2020, according to provisional figures. The exports for Jul-Jan 2020-21 increased by 5.5% to USD 14.245 billion as compared to USD 13.507 billion during Jul-Jan 2019-20. Our cumulative exports for seven months of FY 2020-21 are showing a rising trend. The impact of this export growth on Pakistan's economic stability cannot be overemphasized.

Exporters have achieved this feat despite difficulties, leading to a great degree of textile sector expansion. Value-added exports, including readymade garments, knitwear and other major exports have been showing major increases in both quantity and value. Large-Scale Manufacturing (LSM) in Pakistan grew by 14.5 per cent in November 2020 as compared to the same month in 2019, data released by Pakistan Bureau of Statistics (PBS) shows. It is important to note that the SBP data is depicting a 5% drop in Textile exports whereas the PBS data is showing 10% enhanced exports over the last six months up to December 2020. The difference is entirely due to a disconnect in realization of proceeds and the change in terms of payment from suppliers due to Covid-19.

The enabling environment resulting from these tariffs attracted billions in investments to the sector. According to SBP, out of all TERF applications, around 60 percent came from the textile sector alone. Furthermore, the sector has experienced a $ 1.60 billion investment during the first 6 months of the current fiscal year. The demand for new investment from the textile sector is partially attributed to regionally competitive energy tariffs and concessionary mark ups. To unfold the export potential of the textile sector, the large investment in machinery, skills, and product development, along with supporting policies from government are key areas to focus on.

A PIDE study has highlighted that energy tariffs in Pakistan are high due to operational and commercial inefficiencies, governance issues, ineffective planning, poor policies and sub-optimal energy mix. The unit energy price covers all the inefficiencies and is higher than the cost of service for industrial consumers. Moreover, the study finds that an electricity tariff above 7.5 cents/kwh is regionally uncompetitive. Industrial demand of providing electricity at 7.5 cents/kwh and gas/RLNG at $ 6.5/mmbtu is unassailable.

The impetuous responses from some governmental offices to withdraw the RCET policy or gas suspension have weakened business confidence among producers. The table of regional energy tariffs shows the disadvantageous position of the Pakistani textile sector in terms of competitiveness, in the event of withdrawing the RCET policy. The regional average electricity tariff rate is 7.4 cents/kwh and receiving a tariff rate of 9 cents/kwh can provide a momentary respite to the textile producer but not a long-lasting one.

The study has also 'pointed out' that the share of energy in 2018 was 36.4 percent while during 2020, a one percent decrease was observed in conversion costs. This shows that regionally competitive energy tariffs have categorically reduced the production cost in Pakistan. The share of energy in cost of conversion shows that textile industry in Pakistan is incurring 2.4 percent higher energy costs than India and 7.8 percent higher than Bangladesh.

The current dialogue surrounding regionally competitive energy tariffs suggests replacing RCET with the duty drawback on Local Taxes and Levies (DLTL) scheme. It is proposed that this scheme will be offered to Export Oriented Units (EOUs) of zero-rated sectors. At the exporting stage while filing a return, they will receive a refund against the energy tariffs paid during the production process. This scheme cannot work effectively, and will render the sector uncompetitive. It is only rational to provide direct concessions based on unit cost of service of energy in terms of competitive energy tariffs, rather than providing indirect concession in the shape of DLTL.

DLTL is made further complicated and thus more inefficient as it brings in extra costs of documentation, time and delay. The refund mechanism will incur time and delay costs as release of refunds takes place at the end of the year. It is pertinent to mention that the Government of Pakistan has only recently released the DLTL claims that were pending from 2014. Furthermore, the documentation process for refund claim submission is unnecessarily complex, requiring an audit and verification of claims by a bank.

The textile sector is now expanding at an impressive pace and is in need of unprecedented support to maintain its growth, so direct and timely provision of relief in terms of the energy package will have long-term benefits for the entire economy. In the undesirable case of replacing competitive energy tariffs with DLTL, the textile industry would end up needing to pay electricity tariffs at 14 cents/kwh. Meeting these higher energy costs will result in higher domestically produced output. Thus, the output price will also be uncompetitive; any downstream unit in the value chain will prefer imported inputs instead of expensive domestic inputs. In this case, local units at the higher end of the value chain will be at risk of closing down. This phenomenon would be disastrous for the spinners and it would be tough for them to remain in the market.

It is impractical to depend on a DLTL scheme for energy tariffs as a method to support the whole value chain. The benefits of such a scheme are seldom shared by the value chain, and are likely to neglect the more pressing needs of the industry. Vertically integrated units have the most to gain from such a scheme, and these represent only a minuscule chunk of the industry. Most textile units are not directly involved in the export process and are in fact far removed from it, as they operate downstream.

Therefore, not only would they attain no benefit from such a scheme, they also stand to lose domestic market share.

It is therefore an established fact that the withdrawal of RCET or the implementation of the moratorium on gas would be highly illogical policies. They would shatter investors’ confidence and sully the efforts towards upgradation and value-addition that can make economic growth attainable for Pakistan.

Consistent implementation of RCET policy is therefore essential to remain competitive, achieve sectoral expansion targets and broaden customer base.

Regional Energy Tariffs

Region	Electricity Tariff (Cents/Kwh		Gas/RLNG Tariff (S/mmbtu	
Pakistan		9	Sindh	5.9
			General	6.5
Bangladesh		9		4.05
India	Maharashtra	7.8		4.06
	Punjab	7.1		
Vietnam		7.3		

The PM has the authority to decide which project charged what tariff rates

Textile Exports and Shares of Selected Countries

	Textile Exports (BiU. S)	Pakistan	India	China	Bangladesh	Vietnam
		% Share				
2010	616.28	1.96	4.51	33.92	2.73	2.20
2015	759.80	1.77	5.04	37.73	3.64	3.66
2019	792.82	1.79	4.60	34.69	-	5.08

Source: Calculation base on World Integrated Trade Solution (WITS) database.