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Report Highlights:

Despite a contraction in total cotton production area, Philippine cotton lint output for CY 2005/06 is projected to increase marginally. The Philippines produces only about 3 percent of its total cotton requirements and relies mostly on imports. Cotton lint demand is projected to decline in CY 2005/06 in part due to the weak economy, unregulated entry of smuggled low-priced garments and the abolition of the textile quotas last year. Imports are seen to decline as a result of weak cotton demand. The Value Added Tax (VAT) Reform Law passed last year, lifted VAT exemptions for cotton and cotton seeds, all cotton imports are now subject to VAT of 12 percent.

Includes PSD Changes: Yes
Includes Trade Matrix: No
Annual Report
Manila [RP1]
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Executive Summary

Despite a contraction in total cotton production area, Philippine cotton lint output for CY 2005/06 is projected to increase marginally due to an improvement in yield. The Philippines produces only about 3 percent of its total cotton requirements and relies mostly on imports. Cotton lint demand is projected to decline in CY 2005/06 in part due to the weak economy, unregulated entry of smuggled low-priced garments and the abolition of the textile quotas last year. Imports are seen to decline as a result of weak cotton demand. The Value Added Tax (VAT) Reform Law passed last year, lifted VAT exemptions for cotton and cotton seeds, all cotton imports are now subject to VAT of 12 percent.

Production

Philippine cotton lint output for CY 2005/06 is projected to increase to 2,042 MT due to improved yields of the adopted hybrid cotton varieties, despite a contraction in total cotton production area. Projected production area declined in CY 2005/06 from 4,921 hectares to 3,681 hectares. Currently, the Philippines only produces about 3 percent of its total cotton requirements and relies mostly on import for majority of its cotton demands.

Cotton is cultivated in the three major islands of the country, Luzon, Visayas and Mindanao. During the past 10 years however, production has been concentrated in Mindanao where it has endured less competition from other crops. For CY 2004/05 about 88 percent of the cotton areas was in Mindanao, while Visayas and Luzon shared 8 percent and 4 percent, respectively. Among these areas though, cotton is deemed most suitable in Luzon, which explains the relatively higher yields in the area. Apart from the very favorable agro-climatic conditions, only Luzon is irrigated, while Visayas and Mindanao are mostly rain-fed areas.

As a result of the reported expansion in production area last year, output of cotton lint was projected to reach 2000 MT. However, due to poor cotton yields and pest infestation, official CY 2004/05 cotton production only reached 1,400 MT. According to the Cotton Development Authority (CODA), productivity declined to an average yield of 0.38 MT lint/ha, 19 percent less than the previous year. The highest average yield was attained in Luzon with 430 kg lint/ha, followed by Visayas at 327 kg lint/ha and Mindanao at 323 kg lint/ha. A few farmers in Luzon attained yields almost triple the national average.

Some of the problems that adversely affected productivity are inadequate rainfall, high pest presence, delayed release of production loans, and inadequate technical knowledge of farmers. The latter two factors affected the application of production inputs and led farmers to deviate from technological recommendations resulting in poor plant stand and uncontrolled pests.

According to CODA, domestic lint price is estimated to be equal to the landed cost of imported cotton. Since there is no price support extended by the government, domestic prices are primarily market-determined. Average domestic cotton prices in 2005 dropped to P64.25/kg (\$1.05/kg) from P69.00/kg (\$1.25/kg) in 2004. Due to weak domestic cotton prices, expansion of cotton production areas is expected to remain small.

Average Philippine Cotton Prices¹		
YEAR	Seed Cotton Pesos/kg	Lint Pesos/kg
2003	19.00	94.57
2004	19.33	69.00
2005	19.00	64.25

Source: Cotton Development Authority

Cotton prices vary widely across the country. This is mainly attributed to the differences in marketing cost, an important component of which is transportation. Since textile mills are situated in Manila, Luzon cotton growers enjoy proximity advantage allowing their produce to be transported cheaper than Visayas and Mindanao.

During CY 2004/05, the cotton sector is estimated to have contributed P115 million (\$ 2.0M) to the national economy, a 58 percent increase from the previous year. Currently, there are about 4,000 cotton farmers, basically small landholders with farm sizes ranging from 0.5 ha to 3.0 ha.

Consumption

The GRP recently announced that GDP grew 5.1 percent in 2005, slower than it's projected target of 5.3 to 6.3 percent. The slower growth has been attributed to weaker farm output and slow export demand. Philippine GNP, however, rose by 5.7 percent last year, buoyed by remittances from overseas workers, although still lower than the 6.2 percent GNP growth in 2004. Surprisingly, the significant increase in overseas remittances (which have fueled personal consumption in recent years) did not boost personal consumption to expected levels.

The weak growth in consumption spending has been attributed by many analysts to the prevailing political uncertainty in the country. Average inflation was in the 7.7 to 7.9 percent range in 2005, and is projected at 8.0 to 8.5 percent this year. This year's GDP growth target is between 5.7 to 6.3 percent, lower than the previous GRP estimate of 6.3 to 7.3 percent. Some private analysts, however, predict a flat 2006 Philippine GDP growth rate compared to the previous year's level. Rising consumer and oil prices, as well as the imposition of new and additional taxes, are expected to produce shifts in the consumption pattern of the average Filipino.

Cotton lint demand is projected to decline in CY 2005/06 due in part to the weak economy, unregulated entry of smuggled low-priced garments and the abolition of the textile quotas last year. This complicated situation has prompted local textile mills to adjust their production structures in anticipation of a contraction in demand for their products. For the domestic cotton producers, the impact of this decline in local lint demand is projected to be minimal, as local output is a very small portion of total supply.

Trade

With no substantial increases in domestic cotton production seen in the near future, the Philippines is expected to remain reliant on cotton lint imports. In CY 2004/05, the Philippines imported about \$40 million worth of cotton, or over 95 percent of its domestic cotton requirements. The United States supplied over 65 percent of Philippine imports.

¹ Prices paid to farmers

However, imports of cotton lint are projected to decline in CY 2005/06 as year-to-date imports indicate a significant drop of 27 percent over the previous year's level.

A significant portion of cotton imports is consumed by the local textile milling industry for its garment production. Philippine imports include combed/carded cotton, fabrics, thread and yarn.

While the Philippines exported about \$2.5 billion worth of apparel (88 percent), textiles (5 percent) and non-apparel items (7 percent) abroad, majority of the fabric and textiles used in these items are imported. While the Multi-fiber Arrangement (MFA) quota system for garments and textiles ended in January 2005, the garments and textile industry of the Philippines is generally optimistic that it will be able to compete in a quota-less environment.

In 2005, the Philippines, a major quota recipient under the MFA, exported about \$2.5 billion of garments and textiles or six percent more than the previous year. Over 76 percent of which went to the United States

COUNTRIES	2005			2004			% Growth	
	December	Year-to-Date December	% Share	December	Year-to-Date December	% Share	YOY December	YTD December
United States	164,862,000	1,920,973,000	76%	144,532,000	1,938,084,000	80%	14%	-1%
European Union	21,151,000	288,785,000	11%	24,459,000	207,970,000	9%	-14%	39%
Other Countries	18,756,000	252,722,000	10%	21,448,000	182,364,000	8%	-13%	39%
Canada	5,893,000	79,926,000	3%	7,790,000	80,814,000	3%	-24%	-1%
Subtotal	67,018,000	621,433,000	24%	32,531,000	471,148,000	20%	106%	32%
Total Business	231,880,000	2,542,406,000		177,063,000	2,409,232,000		31%	6%

Source: Department of Trade and Industry

All cotton imports, falling under H.S. 5201.0000 (Cotton, Not Carded or Combed) are assessed a duty of 1 percent. Moreover, effective February 2006, the Value-added Tax (VAT) rate was increased to 12 percent from the original 10 percent. The new VAT rate applies to all food and agricultural products, including those imported, except those considered to be in their original state. VAT exemptions for cotton and cotton seeds have also been lifted. Thus, all cotton imports are now subject to VAT.

Policy

Government support to the industry is primarily confined to research and development (R&D) and extension support, as well as assistance in various semi-commercial activities. Specifically, CODA undertakes the following support services:

- 1) **Production support.** CODA produces quality basic cottonseeds (nucleus, breeder, and foundation seeds) of commercial pure line cotton varieties and provides technical support to private seed growers in the production of registered and certified seeds. Trichogramma production is also undertaken to promote the use of environment-friendly pest management of cotton in the country.
- 2) **Market development.** CODA initiates meetings and market-matching between farmers and legitimate cotton buyers to facilitate marketing agreements between the two parties.

- 3) **Credit facilitation.** Assistance is focused mainly on the conduct of Values Orientation Seminars (VOS) for prospective farmer creditors and processing of loan applications.
- 4) **Post-harvest services.** While privatization of the government ginnery facilities is underway, ginning and warehousing services are being administered by CODA at the moment, through its facility in San Fabian, Pangasinan. The services are offered to farmers and other interested private business clients at competitive prices.
- 5) **Extension support, education and training.** Under this component, efforts focus on five important aspects, namely, industry promotion, trainings, field days, technical assistance, crop monitoring, and production/distribution of IEC materials.
- 6) **Information support.** CODA develops and packages information and industry data in appropriate formats for easy access and use of a multi-level audience. This includes a website, industry database and GIS maps.
- 7) **Policy and Advocacy.** CODA formulates policy recommendations and plans that aim to boost the industry's growth.
- 8) **Research and Development.** A dynamic, demand-driven and problem-oriented cotton R&D agenda is being implemented with emphasis on developing quality and pest-resistant varieties, improving the pest management technology for cotton, generating cost-efficient cultural management techniques, as well as coming up with socio-economic analysis of the industry.

Cotton Industry Roadmap: In 2004, DA approved the Philippine Cotton Industry Roadmap, which seeks to revitalize the domestic cotton industry within 6 years (2004-2010) through mutual cooperation and partnership with various industry stakeholders. The government hopes to substantially increase domestic cotton production and cut down on import dependence.

According to CODA, the roadmap is anchored on six fundamentals for development.

- 1) Critical mass of cotton farmers, credit, ginneries operating at capacity and buying capital are in place;
- 2) Adoption of international practices and trade/business models (i.e., technology, international quality standards, credit and finance facilities);
- 3) Multi-faceted market;
- 4) Private sector-led development;
- 5) Beneficial to all players in the cotton supply chain;
- 6) Free market forces.

Marketing

Ukay-ukay is a popular local term for discounted second-hand clothing stores. The imported second-hand clothing is sent to the Philippines, mostly by Overseas Filipinos Workers, in balikbayan boxes. Since these items are not declared as commercial goods, they enter the country duty-free. This retail development started in the 1960's in Baguio and Cebu and has spread to Manila and as far as Mindanao. Over the past few years, this underground industry has grown steadily which has greatly affected the local clothing industry that is unable to compete with the low-priced goods. This has prompted the government to crack down on the smuggling of second hand clothing. In March 2006, the President ordered the raid of a popular mall in Metro Manila by the Bureau of Customs as part of the government's anti-smuggling campaign.

PSD Table						
Country	Philippines					
Commodity	Cotton					
	Revised	2002	Estimate	2003	Forecast	2004
	Old	New	Old	New	Old	New
Market Year Begin		08/2004		08/2005		08/2006
Area Planted	0	0	0	0	0	0
Area Harvested	5000	4900	5000	3800	0	4000
Beginning Stocks	9362	9176	11104	10226	8274	10286
Production	2395	1400	2613	2040	0	2100
Imports	34183	34150	27216	28500	0	29000
MY Imp. from U.S.	0	0	0	0	0	0
TOTAL SUPPLY	45940	44726	40933	40766	8274	41386
Exports	0	0	0	0	0	0
USE Dom. Consumption	34836	34500	32659	30480	0	31000
Loss Dom. Consumption	0	0	0	0	0	0
TOTAL Dom. Consumption	34836	34500	32659	30480	0	31000
Ending Stocks	11104	10226	8274	10286	0	10386
TOTAL DISTRIBUTION	45940	44726	40933	40766	0	41386