Document of

The World Bank

FOR OFFICIAL USE ONLY

Report No. 8107

PROJECT COMPLETION REPORT

PHILIPPINES

TEXTILE SECTOR RESTRUCTURING PROJECT
(LOAN 2127 - PH)

OCTOBER 6, 1989

Industry and Energy Operations Division
Country Department II
Asia Regional Office

ABBREVIATIONS AND ACRONYMS

ATC	-	Advance Tax Credit
BOI	-	Board of Investments
CB	-	Central Bank of the Philippines
DBP	-	Development Bank of the Philippines
DTI	-	Department of Trade and Industry
MT	-	Metric Tonne (1,000 kilograms)
PCR	-	Project Completion Report
TMP	-	Textile Modernization Program

Government:	Government of the Philippines
South East Asia:	Main competing Garment and Textile producing countries: Thailand, People's Republic of China, Taiwan, Korea, Hong Kong and Japan
Consultants:	Tootal Textiles International Operations
Direct Exports:	Direct Exports of Textiles
Indirect Exports:	Sales of textiles to export garment producers, export shoe producers, or other exported products containing textiles.

THE WORLD BANK
Washington, D.C. 20433
U.S.A.

Office of Director-General
Operations Evaluation

October 6, 1989

MEMORANDUM TO THE EXECUTIVE DIRECTORS AND THE PRESIDENT

SUBJECT: Project Completion Report on the Philippines
Textile Sector Restructuring Project (Loan 2127-PH)

Attached, for information, is a copy of a report entitled "Project Completion Report on the Philippines - Textile Sector Restructuring Project (Loan 2127-PH)" prepared by the Asia Regional Office with Part II of the report contributed by the Borrower. No audit of this project has been made by the Operations Evaluation Department at this time.

Attachment

PROJECT COMPLETION REPORT

PHILIPPINES

TEXTILE SECTOR RESTRUCTURING PROJECT
(LOAN 2127-PH)

Table of Contents

TABLE OF CONTENTS (Cont'd)

PROJECT COMPLETION REPORT

PHILIPPINES

TEXTILE SECTOR RESTRUCTURING PROJECT (LOAN 2127-PH)

PREFACE

This is the Project Completion Report (PCR) for the Textile Sector Restructuring Project in the Philippines, for which Loan 2127-PH in the amount of US$157.4 million (including a front-end fee of US$2.4 million) was approved on April 20, 1982. The loan was closed on schedule on December 31, 1988, but due to a severely depressed economy and other adverse circumstances only a small portion of the loan was withdrawn and utilized. In addition to the front-end fee, final disbursements were US$3.05 million for technical assistance and training, US$9.3 million for a Foreign Exchange Working Capital Fund of the Government during the country's economic crisis and US$0.705 million for a special Board of Investment Account. The remaining US$142 million were cancelled.1/ The last disbursement from the loan was made on March 14, 1989.

The PCR was jointly prepared by the Industry and Energy Operations Division, Country Department II, Asia Regional Office (Preface, Evaluation Summary, Parts I and III) and the Borrower (Part II).

Preparation of this PCR was started during the Bank's final supervision mission of the project in November 1988, and is based, inter alia, on the Staff Appraisal Report; the Loan and Project Agreements, supervision reports, correspondence between the Bank and the Borrower and internal Bank memoranda.

1/ US$100 million effective May 20, 1985; US$40.7 million effective November 19, 1986; and US$1.3 million on March 15, 1989.

PROJECT COMPLETION REPORT

PHILIPPINES

TEXTILE SECTOR RESTRUCTURING PROJECT (LOAN 2127-PH)

EVALUATION SUMMARY

Objectives

1. The project comprised two components: the provision of credit to the textile sector for financing rehabilitation, modernization and expansion sub-projects (the credit line component) and provisions for related technical assistance (the TA and training component). The project was designed to assist the Government in the implementation of its Textile Sector Restructuring Program which, in broad terms, had the following objectives: (i) to produce a competitive and efficient textile industry by 1985; (ii) to have textile mills achieve a greater degree of specialization; and (iii) to obtain a greater share of the export market (Part I, paras. 4.1-4.3).

2. Sector investment requirements for the four-year 1982-85 period were estimated to amount to US$503 million in foreign exchange of which the Bank loan was to provide US$150 million (excluding the front end fee) and suppliers' credits the balance. Local costs, estimated to be equivalent to US$100 million were to be financed by the firms and mills taking part in the credit line component (Part III, paras. 5.1 and 5.2).

Implementation Experience

3. Achievement of the project objectives was based on three key assumptions: (i) domestic and international demand would continue to grow at a rapid rate; (ii) trade policy reforms and incentives would be implemented in accordance with the Government's trade liberalization program supported by the Bank's Structural Adjustment Loan (1903-PH); and (iii) the business climate would remain favorable. However, none of these assumptions proved to be valid; adverse economic and political developments subsequently caused the cancellation of the entire credit line component. Excluding the front end fee, all of the US$150 million loan was cancelled except for US$15.1 million.1/ The project's only bright spot was the TA and training component which was successfully implemented with particularly useful results (Part I, paras. 6.1 and 6.2).

1/ Disbursed as follows: US$3.1 million for the TA and training component; US$9.3 million transferred to the Foreign Exchange Working Capital Fund; and US$0.7 million for a special Board of Investment Account.

Results

4. The project failed to achieve the objectives expected from the credit line component over the 1982-85 project period. However, the TA and training component made steady progress over this period in bringing about industry-wide mill efficiency and output quality improvements. Moreover, the work of consultants assigned to this component was helpful in persuading the Government of the soundness of phasing out import restrictions, instituting lower tariffs and providing export incentives. The results have produced an improved business and investment climate. The present cautiously optimistic view is that the project objectives will be met but at a much slower pace than anticipated during project appraisal. This optimism is supported by the fact that investment volumes which were US$230 million for 1987-80 (versus US$42 million for the entire 1982-85 period) are expected to total US$500 million over the next three to five years (Part I, paras. 7.1 to 7.6).

Sustainability

5. Prospects appear reasonably good that the growing benefits derived from the improved textile sector performance will be sustained. However, the Government must continue to have a sound trade policy and the restructuring steps and sector improvements initiated so far must be maintained (Part I, para. 8.1).

Findings and Lessons

6. The project could not succeed because of unanticipated economic and political adversities. Lessons learned from this failure are that (Part I, paras. 14.1 and 14.2):

(a) prior detailed and vigorous analyses of market trends and volumes and their relationship to investment requirements are a must for this type of project;

(b) industry investments cannot be expected to precede Government incentives and policy reforms;

(c) high inflation and interest rates are a strong deterrent to investments, especially if the investors face substantial foreign exchange risks; and

(d) restructuring projects are likely to benefit from a well prepared TA and training program.

PHILIPPINES

TEXTILE SECTOR RESTRUCTURING PROJECT (Loan 2127-PH

PROJECT COMPLETION REPORT

PART I

1. Project Identity

Project Name	:	Textile Sector Restructuring Project
Loan No.	:	2127-PH
RVP Unit	:	Asia
Country	:	Philippines
Sector	:	Industry
Subsector	:	Textiles

2. Foreword

2.1 Loan 2127-PH (in the amount of US $157.4 million including a front end fee of US$ 2.4 Million) to the Republic of the Philippines was approved by the Executive Directors on April 20, 1982 in support of the Textile Sector Restructuring Project.1/ Cofinancing was to be provided by Suppliers'/Buyer's credits (US$ 317 million) and a syndicated commercial loan of US$ 50 Million equivalent. The project consisted of two parts: (i) US$ 5 million for studies, training and other technical assistance designed to improve sectoral performance and (ii) US$ 150 million to be onlent to the Development Bank of the Philippines for financing rehabilitation, modernization and expansion sub-projects in the textile sector.

2.2 Following approval of the Bank loan, economic conditions in the Philippines, already in a poor state, deteriorated drastically with the onset of a global recession which exposed policy, institutional and structural weaknesses in the Philippine economy and caused a massive recession. The textile industry was particularly hard hit, and as a result demand for investment credit essentially disappeared. The principal causes were the

---

1/ The textile industry is defined to include spinning, weaving, knitting and finishing on man-made and natural fibers. Garment manufacture is not included in this category and has only an indirect connection to the Bank loan.

rapidly declining demand for textiles and the resulting overcapacity and the high interest rates coupled with the increasing reluctance of investors to bear the foreign exchange risk in the face of a rapidly depreciating Peso. As a consequence, no textile subproject was financed from the Bank loan, and only the technical assistance and training components of the project were implemented. The credit component was formally cancelled on November 19, 1985, the effective date of the final cancellation of all funds allocated to this component.

3. Background

3.1 The Philippine textile industry, which remains entirely in private hands, was among the first to be developed following independence. It continues to be one of the most important in terms of manufacturing output and employment. From the early 1950s the industry evolved in an environment characterized by high tariffs and tight import controls. Protected from foreign competition, the industry developed severe operating and structural problems due to lack of specialization, obsolete and aging equipment, poor technical performance and an inadequately trained work force. Compared to its more efficient, export-oriented neighbors, the Philippine textile industry produced almost solely for its captive domestic market high priced goods of poor quality.

3.2 By the 1970s the Government had become acutely aware of the problem created throughout the industrial sector by the distorting import substitution policy. After a series of studies it promulgated the Industrialization and Policy Reform Program for the 1980s which the Bank supported with Structural Adjustment Loan 1903-PH. Also in support of this program a Bank reconnaissance mission reviewed the textile industry in April 1980. On the basis of the mission's findings and further discussions, the Government and the Bank agreed on a textile sector restructuring program which the Bank would support. The program comprised a three-pronged strategy: (i) policy changes to encourage and improve efficiency, (ii) technical and structural improvements, and (iii) financing for rehabilitation, modernization and expansion, and improvement of technical operations.

3.3 The project was prepared by the Department of Trade and Industry (DTI) and the Board of Investments (BOI) with the assistance of the Bank and consultants. It was appraised in March/April 1981, and a post appraisal was undertaken in October 1981 to review cofinancing and technical assistance arrangements, procurement procedures and coordination mechanisms for the restructuring program.

4. Project Objectives and Description

4.1 The main objective of the project was to assist the Government in implementing the textile sector restructuring program and accomplish the following:

a) transform, by 1985, the existing textile industry into a competitive and efficient industry able to produce, at prices and quality comparable to imported textile products, in an environment of unrestricted entry and reasonable levels of tariff protection;

b) achieve a greater degree of specialization, by product and process, for the industry's mills; and

c) increasingly meet some of the requirements of export markets, both directly and indirectly through the export of garments.

4.2 It is clear that these objectives were highly ambitious and relied on a number of key-assumptions: (i) domestic and international demand would continue to grow rapidly; (ii) trade policy reform with regard to textiles would be implemented according to the announced program of trade liberalization, supported by the Bank's Structural Adjustment loan; and (iii) the business climate would remain favorable. As it turned out, none of the three assumptions came true within the time frame envisaged (paras. 5.3, 6.1 and 14.1).

4.3 The project was divided into two main components: (a) the provision of credit through DBP to finance textile subprojects; and (b) technical assistance, provision of which would be coordinated by the BOI within DTI:

Subproject Component

(a) funding of the physical rehabilitation, modernization and expansion of plants in spinning, weaving, knitting and finishing through provision of term financing including suppliers' credits to individual subprojects;

(b) training of technologists, technicians, operators and managers, and technical assistance to individual firms within the context of subprojects;

Technical Assistance Component

(c) setting up of training facilities/programs for the entire textile industry; and

(d) consulting services to assist the Government:

- in the evaluation and supervision of the projects and firms which participate in the restructuring

- in monitoring the impact of the sector program and in developing a textile technology information service; and

- in carrying out studies for improving sector performance in the areas of energy conservation, effluent treatment, local manufacture of accessories, etc.

5. Project Design and Organization

5.1 The project was well conceived: it was in accord with the Bank's lending objective of assisting industrial development in the Philippines; and the timing seemed right for restructuring the textile industry under the Government's industrial development and policy reform program. In addition, the project opened the way for the Bank to assist in setting operational and institutional goals for the textile sector. Also, Bank participation in the project was expected to draw the necessary cofinancing under favorable terms.

5.2 Project preparation was thorough and clearly defined the project's content and objectives. Adequate safeguards were included in project design to ensure smooth implementation by setting forth unambiguous working arrangements and procedures for carrying out the project. The two institutions jointly responsible for implementation, the Board of Investments (BOI) and Development Bank of the Philippines (DBP), were at the time considered experienced in their areas of responsibility: BOI, the Government agency within the Ministry of Trade and Industry in charge of the implementation of investments laws comprised textile experts recruited from the domestic industry. DBP was established in 1958 as an autonomous Government-owned development bank with financing operations (loans, equity and guarantees) covering practically all segments of the economy; it had previously received a number of credit lines from the Bank. Guidelines to be followed by BOI and DBP in evaluating and financing textile subprojects were fully defined in the loan legal documents.

5.3 A major shortcoming of the project design was its optimistic view of general economic performance and development of the Philippines and notably its generously optimistic forecast of domestic demand for textiles based on rather sketchy data and assuming for 1985 a level of consumption which actually has only materialized by about two thirds even in the boom year of 1988. The otherwise careful project preparation and design normally would have produced a relatively trouble-free project barring some disbursement delays, a common minor shortcoming with Philippine projects. It was not anticipated that none of the loan proceeds would be disbursed to fund textile subprojects. The Bank had recognized that the prevailing economic situation and depressed state of the textile industry represented the risk that opposition from influential pressure groups would be able to prevent the enactment of important policy reforms. However, it was not foreseen that economic conditions would deteriorate to the extent that the textile industry would soon be fighting for its survival instead of planning new investments.

5.4 In retrospect, the choice of a government-owned development bank as the sole intermediary was not a wise solution. Bank experience over the past several years has led the Bank to channel credit through multiple institutions, particularly commercial banks. DBP went through very serious financial problems in the early 1980s which required a major rehabilitation

effort in the 1985-87 period. In the event, however, the credit component did not move because of other more significant reasons (macroeconomic crisis). But had that not been the case, the decision to go with DBP could have proven very problematic.

6. Project Implementation

6.1 Implementation of the principal project component comprising the evaluation and financing of textile subprojects got off to a good start with the appointment of consultants in March 1982 and the establishment of a subproject evaluation team, including BOI and DBP officials, in July 1982. Because of the distressed state of the Philippine textile industry at the time, it was decided to proceed with modernization and rehabilitation subprojects first and hold off on the expansion subprojects with their greater financing requirements until later when hopefully conditions would have improved. A substantial number of subprojects were evaluated and approved for financing during 1982-83. However, as already stated, conditions in the industry only worsened, and the implementation effort ultimately had to be stopped. By the same token, the intended removal of quantitative restrictions had to be abandoned in the light of the serious economic crisis which the country faced in the early to mid- 1980s. As a result of the economic crises, coupled with the political upheaval of the mid-1980s, the business climate deteriorated sharply across the Philippines, causing a massive drop of investments in manufacturing. Thus in March 1984 the loan was amended to divert US$120 million (US$40 million in the first tranche) to the Foreign Exchange Working Capital Fund (FEWCF) to help the Government meet its foreign exchange needs. Further deterioration of the political and economic situation resulted in two major loan cancellations: (i) US$100 million effective May 20, 1985 and (ii) US$40.7 million effective November 19, 1985. The textile industry was able to undertake only modest new investments 2/ which were financed mainly from owner's contribution and cash generation.

6.2 On the other hand, implementation of the technical assistance and training component of the project proceeded successfully from March 1982 onward. The services provided by consultants engaged for this part of the project consisted of (i) analyses, studies and development of policy reforms in support of the Government's efforts to rationalize trade-and regulatory policies; (ii) the technical assistance needed by the industry; and (iii) training programs including in-company, counterpart and management training. While the "hard ware" component of the project did not materialize for reasons outside the control of the textile industry, this "software" component helped to lay the foundation for improved industry organization and performance which would allow major investments after improvement in the business climate.

2/ Between 1982 and 1985 only US$42 million were invested as compared to the forecast US$503 million equivalent. In 1986 US$25 million were invested.

7. Project Results

7.1 Because of the economic difficulties during the 1982-85 project period and the collapse of the textile subproject financing program, the three main project objectives (para.4.1) could not be achieved within the envisaged time frame until 1985. Developments since 1985 indicate that these objectives may be achieved, although with much delay and at a slower pace then had been anticipated. Reasons for the optimistic assumption at this time are: (i) the political climate and the economic performance of the Philippines have much improved since 1986 and the domestic demand for consumer goods and notably textiles has recovered significantly with a trend for further growth; (ii) the policy environment, notably with respect to a more open trade policy (QR's on textiles were phased out in 1987) and stimulating policies regarding direct and indirect exports, has much improved; (iii) the effects of substantial efforts of training and technical assistance, provided under the project are being felt; and (iv) the improved business climate in the Philippines has led to renewed investors' confidence, so that investments in the textile industry have started to pick up significantly since 1988.

7.2 By 1985 the technical assistance and training provided under the project began to show positive results as demonstrated by the progress made by some of the better equipped and managed mills in improving quality and efficiency. The technical assistance component also helped to bring about badly needed Government policy changes through the consultant's participation in persuading the Government to phase out quantitative import restrictions, institute lower tariffs and provide incentives for indirect export of textiles.

7.3 To encourage greater participation by the domestic textile industry in the indirect export business 3/, the Government introduced in 1985 the Advance Tax Credit System (ATCS) which allows textile producers to receive a predetermined tax credit covering the amount of taxes and duties due on imports used in the manufacture of textiles and garments for export immediately after such textiles or garments are exported or delivered to a Government bonded warehouse. The sole polyester producer in the country (who was protected against imports by a complete ban on imports) cooperated by agreeing to sell polyester fibers and yarn subject to ATCS at tax and duty free international market prices. The ATCS in combination with improved quality and cost competitiveness, is mainly responsible for indirect textile exports increasing from less than 10% of total textile imports for government exports prior to 1985 to close to 30% by 1987.

7.4 The Philippine textile market recovered briskly during 1987-88 as a result of rapidly rising domestic demand from the previously depressed levels along with the measures discussed above and the improved export market.

3/ The supply of yarn and fabric to Philippine export garment manufacturers to replace the equivalent textile inputs the manufacturers would otherwise have to import.

Direct and indirect exports increased from 8,000 tons in 1983 to 42,000 tons in 1987 and are expected to have posted further significant increases in 1988. The indirect export portion comprised between 25-35% of total textile input, leaving ample room for the local mills to further expand their share of the input. Domestic consumption increased by 14% in 1987, but consumption per person remained very low for the country's level of development. Smuggling, which accounts for about 20% of the domestic market, continues to be a major problem for domestic producers.

7.5 Developments so far indicate that as a result of technical assistance and training and improved Government trade policies (such as removal of quantitative import restrictions, lower tariffs and adequate export incentives) Philippine textile mills can become capable of producing export quality yarn and fabrics at competitive prices. This presupposes also the physical restrictions of industry. Investment volume in 1987 and particularly in 1988 already amounted to over US$230 million. In view of its recent strong performance, the textile sector views its prospects with considerable optimism and plans to invest another US$500 million in capacity expansion and modernization over the next three to five years.

7.6 Overall, while this project, as originally conceived, clearly failed to achieve its objectives within the envisaged time frame (1981-85) for unanticipated reasons, it has clearly contributed to putting in place the policy and institution framework for the textile sector to allow for substantial industry restructuring which would put the industry on a sound footing. These are very essential ingredients for the sustained development of the textile sector which started to recover in 1987 and is continuing to improve.

8. Project Sustainability

8.1 As noted above, the past two years have seen a considerable improvement in the technical and market performance of the Philippine textile sector. These improvements give rise to such benefits as greater foreign exchange earnings, Government revenues and energy savings which are real but not easily quantifiable. The benefits will be sustained so long as the Government continues to have a sound trade policy and the sector improvement and restructuring steps initiated by the project are maintained.

9. Bank Performance

9.1 Bank performance was satisfactory throughout the project cycle. Project preparation and appraisal were detailed and thorough, and project objectives were appropriate and clearly defined. Supervision of the project was adequate. In retrospect, the Bank can be faulted for accepting the textile demand forecast for 1985, established at the time of appraisal. The forecast, which formed the basis for the sector investment requirement, overestimated actual demand in 1985 by over 250%. The economic difficulties could not have been foreseen, but to illustrate how unrealistic the forecast was, it can be noted that even the relatively buoyant 1988 demand is only expected to be about 64% of the 1985 projection. The choice of DBP as the sole conduit for channeling credit was also not a sound decision although

admittedly it was consistent at the time with the normal Bank practice of lending through development finance intermediaries.

10. Borrower's Performance

10.1 BOI, solely responsible for project execution after cancellation of the credit line, satisfactorily carried out what remained of the project after deletion of the subproject component. None of the special covenants in the Loan and Project Agreements were relevant to the reduced project scope.

11. Project Relationship

11.1 The Bank's previous lending operations in the Philippine industrial sector had established a good relationship with the various government agencies involved in the sector and helped to create an atmosphere of mutual understanding and confidence with BOI and DBP. This made it possible to amicably resolve the issues normally arising in the course of project preparation and implementation. The Bank also maintained good relationships with consultants as well as all project participants. As far as could be observed, BOI remained on equally good terms with its consultants, industry representatives and others involved in the project.

12. Consulting Services

12.1 Two British consulting firms each of which provided one of the two services listed below were working from within the premises of BOI with staff from DTI, DBP and industry representatives. The services were:

(a) sector training and technical assistance to help textile mills upgrade their technical operations and reduce costs; and

(b) assistance in sector restructuring, sector studies and setting up sector-wide training facilities and programs.

The textile industry was highly appreciative of these services, and in fact the industry during the past two years (1987-88) has partly funded their contracts which had been extended to March 1989.

13. Project Documentation

13.1 The project appraisal report was comprehensive and gave an excellent background account of the project and its relationship to the Philippine economy. The report precisely stated the scope of the project, the objectives to be achieved and how the project was to be executed, all of which was accurately reflected in the Loan and Project Agreements.

13.2 The supervision reports contain ample description and expository details, but anyone not familiar with the project finds it difficult to form analytical judgments concerning the project and its execution. As a general observation, project supervision reports should be prepared with the view that

they will be an important part in the preparation of a future project completion report.

14. Conclusions and Lessons Learned

14.1 The projects technical assistance and training components can be credited for helping to bring about the turnaround in the textiles industry's fortunes beginning in 1986. However. in retrospect it can be seen that the main project component of funding eligible sector subprojects could not succeed in the face of the obstacles which were encountered from 1982 onward, namely:

(a) the global recession which caused a complete collapse of the domestic textile market already in a poor state because of adverse domestic political and economic conditions;

(b) the delay in implementing Government trade policies, necessitated by the serious recession and economic difficulties in the early to mid 1980s; and

(c) the high interest rates and the foreign exchange burden vis-a-vis a depreciating Peso.

14.2 Experiences gained in implementing the project suggest the following lessons:

(a) a detailed and vigorous analysis of market trends and volumes and their relationships to industry investment requirements should precede project design; in view of the shortage of data at the time of appraisal and resulting uncertainties regarding future market developments, a more conservative market forecast, combined with a smaller loan amount, might prudently have been chosen;

(b) firm Government commitment to, and credibility of policy reforms and incentives announced should precede industry investments; and these policy and incentives reforms should be designed to stimulate exports and foster domestic competition. Appropriate studies and analyses will provide the necessary "vision" of potential subsector development to Government Banking Sector and the industry;

(c) in a situation of rapidly rising inflation, interest rates and the likelihood of major devaluations it is unlikely that major intended investments will take place, particularly when the investor is faced with a substantial foreign exchange risk; and

(d) restructuring projects tend to benefit much from well designed technical assistance and training components at the subsectoral and plant level. These components should cover analyses and studies for the guidance of policy makers as well as sectorwide and plant to specific training and technical assistance.

PROJECT COMPLETION REPORT

PHILIPPINES

TEXTILE SECTOR RESTRUCTURING PROJECT

(LOAN 2127-PH)

PART II

(See Attached Borrower's PCR)

REPUBLIC OF THE PHILIPPINES
TEXTILE MODERNIZATION PLAN (TMP)
(LOAN 2127 PH)

PROJECT COMPLETION REPORT

SUMMARY

1. This Project Completion Report (PCR) presents a review of the loan made available to finance the modernization and rehabilitation of the Philippine Textile Industry. A portion of the loan covered the front end fee, whilst US $5.1 million was allocated for Technical Assistance and Training under the control of the Board of Investments (BOI).

   Total project cost of US $600 million comprises US $157.4 million from IBRD Loan 2127 PH, US $300 million from the suppliers credit, with the remainder to be financed locally by the proponents.

2. The program commenced in March 1982 and the loan was scheduled for completion in December 1988.

   Due to a series of economic problems which commenced shortly after the project started, the majority of the loan was unused and US $140 million was cancelled in two tranches. The technical assistance and training portion of the loan was continued throughout the project period and resulted in:

   a). vastly improved training

   b). improvement in technical performance

c). improved marketing and product development

d). improved commercial awareness

e). a develoomen of the indirect and direct export markets

3. The objectives of the loan were to modernize and rehabilitate the textile industry so as to improve its quality and competitiveness. In addition to the machinery requirements, technical assistance and training programs were undertaken and a program e tablished for tariff adjustments and liberalization of imports.

4. Total domestic demands were estimated based upon the demand trends within the 1970's. It was estimated that a portion of the output would be exported and a further portion sold to the indirect export market.

5. The loan failed in achieving its objective of providing funds to purchase machinery to modernize and rehabilitate the textile industry and no funds were drawn down to cover this aspect of the project. Of the US $150 Million made available for such a purpose, US $140 Million was cancelled and US $9.7 Million was drawn down by the Philippines Central Bank and utilized for the Foreign Exchange Working Capital Fund (FWECF).

6. Textile Investment by the Industry in the period expected 1982 to 1985 was negligible and any investment made was carried out by utilizing private funds.

7. However, the Technical Assistance Fund and Training aspects of the loan have been highly successful. The introduction of Training Officers within the major textile companies, coupled with Job Instructor courses and the provision of systematic training techniques began to improve productivity and quality within the factories. The direct technical assistance given to spinning, weaving, printing, dyeing and finishing also greatly contributed to the improvement in quality.

In the field of energy conservation, considerable savings to the nation in foreign exchange have been achieved as a result of technical assistance given in engineering. Eleven new Philippine fabricated steam raising boilers which burn waste solid fuels in place of oil, have been installed in various Dyeing and Finishing plants. Together with improved steam engineering and general maintenance, which have reduced steam transmission losses between boiler and machine, many companies have been able to obtain significant reductions in fuel costs.

8. During the period 1982-1984, the consultants evaluated many projects put forward by the textile proponents for modernization and rehabilitation. Several projects were approved, but others were not accepted due too the very poor financial state of the companies concerned. It was apparent however to the consultants that all projects were based upon sales to a domestic market, which was

rapidly shrinking, and that the proponents had no desire to borrow foreign exchange in a highly unstable economy which had seen the Peso drop from ₱8.00/$1 to $20.00/$1. None of the approved projects were implemented.

9. During 1985, government, industry and the consultants considered methods by which the textile industry could become competitive in direct exports and more particularly in supplying textiles to the flourishing export garment makers who were importing all of their textile requirements. To achieve success in this market meant several changes in government restrictions regarding the refund of the high taxes and duties charged on imported textile raw materials and consumables, improved product development, and a completely new marketing strategy for the textile manufacturing companies.

10. An Advance Tax Credit System was proposed and accepted by the Government. This system allows a refund of the taxes and duties paid by the textile mills when textiles were delivered to the Bonded Warehouse of export garment makers. Included as part of the scheme was an undertaking by the local Polyester producer to reduce its prices substantially for polyester utilized for such textiles. The result of these moves allowed the products to be sold at competitive world prices to the export garment makers.

11. Continued emphasis by the consultants on product development, marketing skills and customer awareness has enabled the industry to vastly improve its exports (direct and indirect). In 1987, exports amounted to 31% of the Philippine Textile Production and preliminary estimates for 1988 indicate a similar encouraging performance.

12. The result of the increased output and confidence of the market has resulted in an improved investment scenario with US $237 Million being invested over 1987/1988 compared with US $42 Million in 1982/85 and US $25 Million in 1986. Virtually, all of this investment is being funded through private means or through normal commercial banking channels.

13. During the latter part of 1988, the Government requested the textile industry millers to put forward investment proposals for the three year period 1989-1991 under an Accelerated Investment Program.

The total value of proposals received is US $502 Million, of which it can be reasonably expected that some 70% or about US $350 Million will be implemented subject to funds being available.

It should be emphasized, that because of the heavy losses due to adverse foreign currency exchange movements experienced in the past, many millers will be reluctant to take up loans that are not protected against exchange risks. This will have the effect of slowing down the proposed expansion and modernization program.

The original draft of this Project Completion Report was prepared by Tootal Textiles International (Consultants) who were retained by the Board of Investments (BOI), an agency of the Department of Trade and Industry (DTI), throughout the period of the loan.

PHILIPPINES - TEXTILE MODERNIZATION PLAN

PROJECT COMPLETION REPORT

1. INTRODUCTION

1.1 In the late 1970's, the Minister of Trade and Industry identified several key industrial areas to promote the growth of wealth and employment within the Philippines. The textile industry was the second of the industry groups to be considered, and a series of studies were undertaken in the late 1970's and early 1980's to establish the requirements of the industry.

1.2 The textile industry commenced in the Philippines during the early 1950's to meet the demands of the wholesalers who had previously imported all textile products. Textile production commenced with many of the new companies being financed and managed by the original traders and wholesalers or their families, a wide range of product were produced to supply the wholesale market. Because of the lack of manufacturing experience and expertise and the protected market, the products were generally of inadequate quality and expensive. Factory efficiency was poor and productivity low.

1.3 The various studies recommended that a series of steps should be taken to improve the textile industry and to further its growth and employment

of labor. Government and the textile industry adopted a Textile Modernization Plan to:

a). provide funds to modernize and rehabilitate the textile industry.

b). provide technical assistance and a training program for the industry.

c). improve energy conservation, effluent control and other desirable elements.

1.4 The Textile Modernization Plan envisaged expenditure originally over the 1981/85 period of US $600 Million made up of:

(US$ Million)

	Rehab.	New	Total
Spinning	37	99	136
Weaving	34	102	136
Knitting	-	17	17
Finishing	22	30	52
TOTAL	93	248	341
Engineering			34
			375
Contingency, 20%			75
Total Foreign Investment			450
Local Investments (civil works, initial working capital, etc.)			100
		TOTAL COST	550

(Figures taken from Board of Investments leaflet "The Philippine Textile Industry Modernization Program 1981-1985")

2. PROJECT BACKGROUND

2.1 Following a request from the Ministry of Trade and Industry and taking into account the various studies, a package was agreed between the bank, suppliers, the government and the textile industry to finance the Textile Modernization Plan as follows:

	US$ Million
Bank	150.00
Suppliers Credit	300.00
Proponents Input	150.00
Total	600.00

2.2 The bank disbursements of US $150 Million were to be through the conduit of the Development Bank of the Philippines, whilst in addition to the front end fee, a loan of US $5.1 Million would be disbursed by the Board of Investments for Technical Assistance and Training.

2.3 The market growth trend for domestic consumption of textiles was expected to continue, and in addition, exports were planned for both direct exports and sales to the indirect export market.

The supply and demand situation for the year 1985 was planned as being:

Demand '000 MT		Supply '000 MT	
Domestic	149	R.P. Supply	181
Direct Export	10	Imports	nil
Indirect Export	22	Smuggled	nil
Total	181		181

Compared with a situation in 1979 of:

Demand '000 MT		Supply '000 MT	
Domestic	140	R.P. Supply	115
Direct Export	3	Imports	nil
Indirect Export	7	Smuggled	35
Total	150		150

2.4 Textile consultants were to be appointed to give Technical Assistance to the project and specialist training experts were to be engaged.

2.5 The loan, initially due to commence in 1981, finally commenced in March 1982, and Tootal Textile International Ltd. were appointed as consultants to provide the technical assistance and Fielden House Productivity Centre were engaged to provide training expertise.

3. LOAN OBJECTIVES

3.1 As inferred by its name, the objective of the loan was to modernize the Textile Industry of the Philippines which had grown since the 1950's to service a highly protected domestic market. The majority of existing textile mills were vertical organizations producing products to service their associated wholesaling organizations. These associated wholesalers helped to finance the textile mills in difficult times and profitability between the textile mills and their wholesales was difficult to assess.

Generally speaking, mills produced poor quality mechandise at high prices due to inherent inefficiencies and the protection given by a ban on the importation of textiles and garments.

3.2 The objective was to be attained by:

a). Making funds available as part of a package, including suppliers credit, to modernize the textile industry by installing modern machinery and rehabilitating existing machinery where this method was economic. The projections also saw a large expansion of the industry which required more machinery in addition to the added capacity gained by modernizing and rehabilitating existing machinery.

b). Making available international technical assistance to improve existing manufacturing techniques and to direct the training requirements of the industry so as to improve technical knowhow, efficiencies and operating efficiency levels.

c). Phasing in the liberalization of textile and garment imports together with restructured tariff rates.

d). Transfer of knowledge to the textile counterparts at the BOI.

3.3 At the end of 1985, the industry would be capable of meeting the following market demands:

	'000 MT
Domestic	149
Direct Export	10
Indirect Export	22
	181

4. UTILIZATION OF THE BANK LOAN

4.1 Prior to the loan, a complete list of accredited suppliers were established by the BOI in accordance with the established requirements, and arrangements were made to provide the suppliers credit portion of the loan.

4.2 In the event, during the years when the program was due to operate (1982-1985), the Philippines underwent a severe economic crisis which had the following results:

a. Major contraction of the domestic market for textiles and garments.

b. A series of devaluations from ₱8.00/$1 to ₱20.00/$1.

c. A severe restriction of foreign exchange.

d. A large increase in domestic Interest Rate to over 40%.

e. Lack of foreign confidence.

f. The collapse and withdrawal of lending facilities of the conduit bank - the Development Bank of the Philippines (DBP).

4.3 As a result of these problems, the majority of textile companies made huge financial losses with those having foreign loans from investments made in 1979-1981 being amongst the hardest hit. The industry lost confidence and

the prime objectives of the textile millers became survival by decreasing current assets, reducing costs, and financial restructuring of their companies.

4.4 Investment in new plant and machinery during the period 1982-1985 is calculated as being:

	US$ Million C & F
Foreign Exchange	
Spinning	12
Weaving	15
Knitting	6
Dye/Finish	2
Others	2
	37
Local Exchange	
Duties, taxes, local works and working capital	5
	42

4.5 The majority of this expenditure was incurred by multinational companies or by Philippine conglomerates who could finance their investments through other channels. A further portion was invested by down stream manufacturers, garment makers or shoe manufacturers, who could not get the fabric service which they required from the industry.

The Bank Loan and suppliers credit were not utilized by the investors due initially to the high interest rate for the loan and their desire to avoid further foreign exchange exposure. To a small extent, in the later part of the period, the absence of a conduit bank following the collapse of the DBP had some effect.

4.6 Accordingly, it was agreed that US $10 Million of the loan would be transferred to the Philippine Central Bank (CB) and US $9.7 Million of that amount was eventually drawn down by the CB in 1984/1985.

4.7 A further US $140 Million of the loan was cancelled.

4.8 The Technical Assistance and Training component of the loan has continued from March 1982 to March 1989, and has consisted of technical assistance, in-company training, management training, counterpart training within the BOI and other requirements of the textile and associated garment industry. The funds have been generally adminis-tered by the textile consultants, in collaboration with the BOI and the Bank.

Expenditure on this portion of the loan has been US $3,062,794.81*.

* The final figure will be dependent upon the exchange rate used by the W.B.

5. OPERATING PERFORMANCE OF THE INDUSTRY

5.1 When the project commenced in 1982, the industry was beginning to experience a rapid decline in its fortunes, with a declining domestic market, increasing losses and a bleak future. The tendency of many companies was to combat these losses by reducing the quality of raw materials together with layoffs and short time working. The result was generally poorer quality fabrics, lack of fabric developemnt, and poor operator performance. The image of the industry, to both garment makers and the public, was one of poor quality, high prices and unreliable delivery.

5.2 As the market reduced and activity levels within the factories dropped, the textile mills and the polyester fiber supplier, FILSYN, increased prices to cover the shortfall in earnings. This made the domestically produced textiles even more unattractive and increased the profits to be made by smuggling better quality textiles at cheaper prices into the Philippines.

5.3 Little thought was given to investment by the textile millers who foresaw a long term lack of domestic demand and were unable to export fabrics due to:

a. Poor quality.

b. Lack of product development.

c. Inability to meet prices through:

1. Low plant utilization
2. High polyester prices
3. High power costs
4. High taxes and duties on imports associated with red tape which effectively barred the polyester producers, the spinners, knitters and weavers from recovering the taxes and duties if the eventual end-product was exported.

5.4 During the period 1982 to 1985, the industry gradually declined in the period when other neighboring countries were expanding their textile base.

5.5 However, the extensive training programs which were carried out for the industry, by the consultants, in 1982, 1983 and 1984 were beginning to prove fruitful, in the manner in which, operatives and management in several of the better equipped mills were working to improve quality and efficiency. This, together with the direct technical advice given by the consultants on spinning, weaving, knitting, dyeing & finishing, demonstrated that several mills could produce the fabric and yarn quality required for making export garments.

5.6 Detailed synthesized costings were carried out taking into account costs particular to the Philippines and it was demonstrated to the textile millers that certain textile products could be sold at competitive prices and textile mills could improve their profitability if:

a. A system could be found to refund taxes and duties paid on imported products used for producing the textiles.

b. Poyester fibers and yarns were sold at competitive world prices.

c. The mills continued to improve their efficiency, quality, marketing abilities and product development.

Several yarns and fabrics containing finer counts of yarn could not be considered as profitable until such time as the Philippine government were able to reduce the cost of power which was 60%-70% higher than competing countries.

5.7 The government, industry and the consultants worked together to produce a scheme which would allow the textile producers to receive a predetermined tax credit covering the amount of taxes and duties paid on individual types of textile products. This tax credit would be made available immediately after the textiles had been exported or had been

constructively exported (delivered to the Customs Bonded Warehouse of a registered exporter).

This scheme became operative in mid 1985 and was called the "Advance Tax Credit System". By using a complex data base, the Standard Rates for the whole range of textile products could be adjusted for changes in Exchange rates, tariff and tax changes or raw material price changes within the period of 10 working days.

5.8 The introduction of the scheme, coincided with a marked slump in the South East Asia textile industry which resulted in extremely low prices for textiles particularly from Taiwan and Hongkong. Competitive prices even after taking the Advance Tax Credit Scheme and low polyester prices into account, resulted in net income being only slightly above total variable cost and many mills were reluctant to enter the export market on this basis.

5.9 However, several of the more aggressive textile producers used this period to establish marketing links with the export garment makers, is spite of the extremely low return, and these companies were the first to benefit when the upswing in demand, prices and profits occurred in mid 1986.

5.10 The years of 1986, 1987 and 1988 have shown only a relatively small growth in domestic demand, of which about 20% has been supplied by smuggled goods either by outright smuggling, technical smuggling or by excessive barter trading.

5.11 However, the exports, both indirect and direct, of textiles has continued to improve substantially through the period, and this has been associated with further improvement in quality and substantial investment in new plant and machinery.

5.12 1987 became a record output year for the textile millers in terms of output.

Comparative figures with 1986 were:

'000 MT	1987	1986
Domestic Market Consumption	98	86
Kgs./Capita	1.7	1.5
Supply to Domestic Market		
Philippine Production	82	72
Smuggled	16	14
Legal Imports	-	-
	98	86
Textile Output of Philippines		
Domestic	82	72
Direct Exports - Filament Yarn	2	2
Other Textiles	8	3
Indirect Exports	27	12
	119	89

Notes:

a. Although 1987 domestic market demand was 14% higher than in 1986, it is still below the domestic demand of 1975.

b. Textiles produced by the Philippine industry were 34% higher in 1987 than in 1986.

c. During 1987, the textile industry supplied about 21% of the requirements of the export garment industry.

5.13 The domestic market figures reflect the lower priority given to textile purchases in the family budget, this is due to increasing demands of educational and other costs as the school population continues to increase rapidly, and also in some measure to the loss in purchasing power of the family net disposable income.

'000 MT	1988
Domestic Market	98
Kgs./Capita	1.68
Supply to Domestic Market	
Philippine Production	73
Smuggled & Misdeclared Imports	20
Legal Imports	5

Textile Output of Philippines

	1988
Domestic	73
Direct Exports - Filament Yarn	2
- Other Textiles	7
Indirect Exports	59.6
	141.6

Note: Smuggling has increased in absolute and percentage terms during 1988.

5.14 The government have now liberalized the importation of fibers, yarns and fabrics. Tariff barriers are:

10% - Cotton, acrylic fibers and other fibers except for rayon polyester.

20% - Polyester and rayon (A)

30% - Yarn

40% - Fabrics

50% - Garments

It is considered that these tariffs should give adequate protection for the textile millers against legitimately priced imports.

Note (A) Rayon should be 10% until the proposed Rayon Fiber plant is in operation from which the rate should be 20% (Legislation delayed).

5.15 In spite of liberalization, it would appear that smuggled goods still continue to take a significant portion of the market and misdeclaration of volumes and/or values is resulting in a loss to the textile millers of the domestic market in spite of the fact that their products are now competitive against legally imported textiles.

5.16 The Philippine government is considering legislation to give specific values for duty purposes on imported textiles which will give added impetus to the domestic producers. The government have also reduced power costs by about 20% in 1988. This welcome reduction still leaves power costs about 25% higher than competing countries but, nonetheless, it does give the textile millers a chance to widen the base of products which they could export.

5.17 There is a requirement to continue modernizing and rehabilitating the industry and it is considered that about US $350 Million will need to be spent in the next three years in order to continue to improve competitiveness and quality and to vastly improve the range of products which they can produce.

5.18 There remains a good opportunity for the textile industry to continue expanding in the Philippines based on an increasing share of the textile products required for the export garment market.

Textile and Garment Exports - 1988

Quota Countries

	FOB Value (US$)
USA	918,148,513.91
EEC	313,916,313.24
Canada	48,822,444.22
Norway	3,743,977.27
Sweden	5,755,143.44
Austria	3,335,010.09
	1,293,721,402.17

Non-Quota Countries

Australia	10,893,795.60
Japan	52,768,901.11
Others	145,797,073.60
	209,459,771.11
TOTAL	1,503,181,173.28

Exports to EEC Countries:

	FOB Value (US$)
Benelux	43,118,162.07
Denmark	9,865,901.47
France	61,509,138.51
Greece	153,726.85
Ireland	1,763,130.88
Italy	10,615,608.63
Great Britain	64,904,316.73
West Germany	119,595,237.48
Spain	2,283,724.66
Portugal	107,365.96

Exports to Leading Non-Quota Countries	FOB Value (US$)
Japan	52,768,901.91
Hongkong	38,539,270.16
Panama	35,407,742.37
Kingdom of S. Arabia	17,596,085.85
United Arab Emirates	11,967,118.71
Australia	10,893,795.60
Curacao, N.A.	4,678,184.81
South Korea	4,378,024.52
Switzerland	2,978,169.94
Egypt	2,926,460.80

5.20 The essential ingredients are:

a). Greatly improved product development and variety of fabrics.

b). Increased investment in the industry particularly in the dyeing and finishing section.

a). and b). will probably require the installation of a new independent commission dyeing printing and finishing mill.

c). A more sophisticated and professional approach to marketing and sales which will come with greater exposure to external marketing situations.

d). The continuation of the Advance Tax Credit Scheme.

e). Continued training of technical and management staff by expert consultants or more suitably and permanently by the establishment of a Technical College for Textiles and Garments.

6. POLYESTER FIBER PRODUCER (Brief History)

6.1 Filipinas Synthetic Fiber Corp. (FILSYN) was incorporated in 1969 and Lakeview Industrial Corp. in 1972. These two companies produced polyester fiber as part of the import substitution policy of the government of the day.

6.2 The whole output of the two plants was directed towards the domestic market and the manufacturing size of the plants was determined on a measured capacity basis.

6.3 Little or no account was taken of the need to achieve a basic economic production unit, the plants are therefore small when compared with those of local international competitors hence they are unable to achieve the economies of scale which are necessary in order to be competitive.

Further disadvantages such as high interest rates, power and energy costs compounded the situation.

The two companies were not commercially viable unless protected by very high tariff barriers.

6.4 Lakeview was a separate entity which failed financially and because of the large exposure of certain banks, it was virtually forced upon Filsyn and became part of that company in 1983.

6.5 The Advance Tax Credit Scheme was introduced in late 1985, and as part of the scheme, Filsyn agreed to remove its objection to the import of polyester and to sell its own product for export at competitive world tax and duty free prices. For this agreement, an advance tax credit value was calculated of each polyester product type.

6.6 The local textile manufacturer pays to Filsyn the current domestic price for polyester and gets a rebate from Filsyn equal to the difference between the current domestic price and the current export price ruling at the time of the contract, plus interest on the differential amount for the following periods:

a). 60 days max. - Yarn supply

b). 90 days max. - Knitted Fabric supply

c). 120 days max. - Woven Fabric supply

Values being updated periodically by BOI consultants.

7. POLYESTER FIBER PRODUCER (Present Position)

7.1 The new policies of import liberalization were implemented during 1987 with a reduction in tariff on imported polyester and the removal of all restrictions on importing.

7.2 Unfortunately, the tariff reduction was not carried out in a balanced manner with regard for the overall competitive position of Filsyn, no reductions in duty were made on the raw materials required for polyester production. Filsyn therefore moved into a high trading loss situation in 1988. The position is critical, financial restructuring is needed immediately.

It is worth noting that competitor countries such as Taiwan and Korea do not impose duties on polyester raw materials.

8. FINANCIAL PERFORMANCE OF THE INDUSTRY

8.1 The manner in which accounts are produced and filed in the Philippines, together with the general standards of auditing and tax collection make it difficult to assess the real picture of profitability in any one year for the industry as a whole. Two of the larger textile companies operating are trading arms of a much larger business not connected with textiles and it is not possible to distinguish the textile portion within that company's annual accounts.

8.2 The millers are reluctant to supply profitability figures and mandatory returns should be regarded as unreliable.

8.3 However, from the accounts which can be judged to be fairly accurate and from a general appreciation by the consultants on the pulse of the industry, it can be judged that the industry as a whole achieved the following:

1982	-	Break-Even
1983	-	Small Profit
1984	-	Considerable Losses
1985	-	Considerable Losses
1986	-	Small Profit
1987	-	Considerable Profit
1988	-	Reasonable Profit

9. INDUSTRY INVESTMENT

9.1 The investment in the industry over the period 1982-1988.

US $ MILLION

	Foreign Exchange C/F Value	Working Capital & Other Peso Costs	Total
1982/1985	37	5	42
1986	22	3	25
1987/1988	189	45	234
Total	248	53	301

10. CONCLUSIONS AND LESSONS LEARNED

10.1 This project was based upon an assumption that domestic sales which had occurred from 1971 to 1979 would continue to show a similar growth pattern through to 1985. In addition to this growth, a quantity of goods were expected to be sold to both the direct and indirect export market and that no fabrics would be imported or smuggled for the domestic market.

10.2 It would appear that the marketing projections assumed that the modernization and rehabilitation of the machinery, along with a training program and the liberalization of imports with suitable tariff barriers, would allow the textile millers to produce all of the domestic demand and also expand into the export market.

10.3 The projected output was widely optimistic and made several important errors.

1. Whilst the economic collapse of the Philippine economy could not have been foreseen, the level of domestic expenditure on clothing could have been expected to fall as the Philippine population continued to grow at a fast rate with the average age of the population continuing to decline. Expenditure could have been expected to increase on food, education and transport all at the expense of textiles.

2. One of the main items in the objectives was to liberalize imports with suitable tariff barriers. <u>However, no allowance appears to have been made for imported textiles when assessing the supply/demand position.</u>

3. <u>Similarly, no allowance was made for smuggled goods</u> although there had been along history of such activities. The growing export garment making industry would also make technical smuggling much easier.

4. <u>No detailed product cost analysis was carried out.</u> A detailed analysis of simulated costings for ranges of textile products would have shown that the industry had a little or no chance of achieving exports due to:

   a). Inherent high costs of the Philippine textile mills which were not associated with mill efficiency levels.

   b). Government bureaucratic systems, making it virtually impossible for independent spinners, weavers and knitters to recover the high duties and costs paid on raw materials which were made up into export products. Vertical companies having to wait up to two years for such refunds.

Even if the textile industry had modernized and rehabilitated its plant and machinery, there could have been no significant entry into the export market as the mills could not be competitive.

10.4 As a result, the marketing projections for demand made for the project were vastly different than the actual demand at the end of the original project period.

'000 MT	Projected 1985	Actual 1985
Domestic		
Demand	149	75.4
Supplied by		
Smuggled/Import	-	16.0
Philippine Production	149	59.4
Total Philippine Supply		
Domestic	149	59.4
Direct Export	10	6.1
Indirect Export	22	6.0
	181	71.5

10.5 As a result of the implementation of the TMP in 1982, based upon the projected volumes, the government, the bank and the consultants brought pressure on existing textile mills within the Philippines to put forward their detailed proposals for investment.

Many projects were examined in great detail and evaluation reports produced by the joint team of DBP, BOI and the consultants. It was some time before it became apparent that it would not be possible to achieve the volumes forecasted and that the proponents had no real intention of proceeding with the projects until such time as the market conditions improved.

10.6 It was at this time that the work had to be started, through the marketing, commercial and accountancy functions to establish:

a. Which product lines were suitable for export?

b. At which prices did the mills have to sell to be competitive?

c. What was the cost structure for producing such products?

d. What actions had to be taken to make the product commercially viable.

e. What technical assistance did the mills require to meet the export quality standards?

10.7 <u>It was only after this analysis had been completed</u> and action taken by introducing the ATCS and providing direct technical assistance that the textile mills found themselves in a commercial environment to market their products.

10.8 It is recommended that much greater emphasis is given in future projects to the marketing and commercial aspects of the program, and that detailed product production cost analysis be used to establish relative values between locally produced fabrics and imported fabrics.

It is recommended that the realities of "red tape bureaucracies" causing excessive delays resulting in effective non-recovery are fully allowed for before any government incentives, credits or duty rebates etc. are taken into account in any cost calculations.

The commercial infrastructure in the country should be fully understood and favourable conditions established before the project begins (perhaps this could be first portion of any actual project). The physical investment in plant and machinery should follow and not precede this exercise.

10.9 There was a very real need to modernize the textile industry when the project started. If the commercial infrastructure had been put into place in 1982, the proponents may have found it favourable to invest in 1984-1986 rather than in 1987-1989 to improve quality and supply the growing indirect export market.

10.10 Overall, taking into account that the bulk of the loan was returned (not wasted) and that only a relatively small amount was used for consultant services, the Bank has helped the Philippine Textile Industry through the provision of funds for the technical assistance and training which enabled many companies to take advantage of the upturn in trade during the last two years and transformed a sinking industry into one which the textile millers now have confidence in and are prepared to invest in for future development and expansion.

Annex 1

Prices Trends of Textile Raw Materials and Finished Products

Based upon major items influencing prices in South East Asia

		MAY 1983	MAY 1984	MAY 1985	MAY 1986	AUG 1986	MAY 1987	AUG 1987	MAY 1988	JUL AUG 1988
Fibre price US $/lb										
Cotton										
Coarse Counts	(A)	68.15	64.9	54.65	37.75	27.75	75.65	82.75	59.5	57.2
132 Middling	(A)	80.1	88.7	64.65	44.6	38.0	80.6	87.7	65.6	62.6
Polyester										
Taiwan	(A)	52.0	62.0	51.0	49.0	47.5	56.5	56.5	54.0	69.0
Rayon										
Taiwan	(B)	-	-	52.0	49.0	47.0	63.0	64.0	70.0	81.5
Yarn Prices for Knitting US $ Kg.										
65/35 TC 45's (Taiwan)	(A)	3.28	3.33	2.53	3.11	3.39	4.00	4.22	4.16	3.91
32's Carded Cotton (Twn)	(A)	2.73	3.42	2.51	2.95	2.75	3.31	3.31	3.33	3.20
Woven Fabrics US $/Yard										
47" Loomstate										
110x76 TC 65.35 45 x45 (Taiwan)	(A)	0.52	0.57	0.48	0.58	0.55	0.78	0.78	0.72	0.66
48" 13.75 oz. Denim (Hongkong)	(A)	1.47	1.62	1.29	1.30	1.30	1.64	1.92	1.73	1.53

(A) SOURCE - Average for month from weekly issue of Cotton Outlook.

(B) SOURCE - Average of quoted prices from major taiwan suppliers during month.

Annex 2

PHILIPPINE TEXTILE INDUSTRY

DEMAND AND SUPPLY 1972-1988

IN THOUSAND METRIC TONNES OF YARN

	DEMAND				SUPPLY		
Year	Domestic CONSUMPTION	KGS/ CAPITA	(A) EXPORTS	TOTAL DEMAND	LOCAL PRODUCTION	SMUGGLED	LEGITIMATE IMPORTS
1972	92	2.4	2	94	71	23	0
1975	99	2.4	5	104	88	16	0
1979	140	3.0	10	150	115	35	0
1980	108	2.3	15	123	96	27	0
1981	106	2.1	16	122	96	26	0
1982	103	2.0	11	114	81	33	0
1983	94	1.8	8	102	88	14	0
1984	78	1.5	10	88	76	12	0
1985	75	1.4	12	87	71	16	0
1986	86	1.5	17	103	89	14	0
1987	98	1.7	37	135	119	16	0
1988(C)	98	1.6	43	141	116	20(B)	5

Note: (A) - Includes sales of Filament Yarn produced in the Philippines but excludes exports of Ramie tops which is considered as a partially processed raw material.

(B) - Smuggling directly or via excessive barter trade or technical smuggling by garment makers.

The figure for 1988 includes an assessment for imported textiles which have been underdeclared in value or volume and which cannot be included in legitimate imports.

(C) - Figures for 1988 are provisional only.

Annex 3

ANALYSIS OF PHILIPPINE TEXTILE EXPORTS

Year	Total Exports	Direct Exports of Filament Yarns	Direct Exports of Other Textile Products	Indirect Export
1980	15	3	10	2
1981	16	3	10	3
1982	11	3	6	2
1983	8	3	3	2
1984	10	3	3	4
1985	12	4	2	6
1986	17	2	3	12
1987	37	2	8	27
1988	43	2	7	34

Annex 4

PHILIPPINE CURRENCY FLUCTUATIONS

Currency Unit - Peso (₱) Fiscal Year Jan. 1st to Dec. 31st

Exchange Rates:	1978	US $1 = ₱ 7.38
	1979	₱ 7.38
	1980	₱ 7.51
	1981	₱ 7.90
	1982	₱ 8.54
	1983	₱ 11.11
	1984	₱ 18.00
	1985	₱ 20.00
	1986	₱ 20.50
	1987	₱ 20.50
	1988	₱ 21.50

PHILIPPINES

TEXTILE SECTOR RESTRUCTURING PROJECT (LOAN 2127-PH)

PROJECT COMPLETION REPORT

PART III

1. Related Bank Loans

The following loans were related to the project:

Credit No.	1903-PH	1984-PH
Title:	Structural Adjustment Loan	Industrial Finance Project
Purpose:	To support the implementation of a comprehensive industrial development program designed to accelerate industrial growth, expand employment and maintain the growth of exports	To finance economically and financially viable projects in the industrial sector and support industrial reforms.
Year of Appraisal:	1980	1980
Status:	Loan Closed	Loan Closed
Comment:	Loan was successfully disbursed on schedule.	US$105.4 million of the US$150 million loan was cancelled, at various occasions between 1981 & 1988. Disbursement targets could not be met because of requirement that subborrowers assume foreign exchange risks and subsequent adverse political and economic developments which severely suppressed demand for credit.

2. Project Timetable

Item Date	Date Planned	Date Actual
First Presented to the Bank	-	March, 1980
Identification	-	October, 1980
Appraisal	March, 1981	March, 1981
Loan Negotiations	March, 1982	March, 1982
Board Approval	April, 1982	April 20, 1982
Loan Signature	June, 1982	June 30, 1982
Loan Effectiveness	July 30, 1982	December 23, 1982
Loan Closing	December 31, 1988	December 31, 1988
Loan Completion	December 31, 1988	March 14, 1989 /a

/a Last disbursement from the loan.

3. Loan Disbursements

The disbursement schedule prepared during project appraisal showed the US$150 million loan amount (exclusive of the US$2.4 million front end fee) disbursed over a six-year period (FY 1983-88) in accordance with the disbursement profile for the Philippines industrial sector. In addition to the front end fee, actual total disbursements were US$3.05 million for technical assistance and training, US$9.3 million for the Foreign Exchange Working Capital Fund and US$0.705 million for a special BOI account. The US$1.315 million amount not previously cancelled (US$100 million effective May 20, 1985 and US$40.7 million effective November 19, 1986) and unutilized was cancelled on March 15, 1989.

4. Project Implementation

The project implementation plan provided for monitoring various aspects of the textile sector's structure, development and performance, but there was no fixed schedule with indicators and milestones to measure implementation progress. It was assumed that six years would be adequate to complete the planned technical assistance and training programs and to meet the financing requirements of the subprojects. This was a reasonable approach because it was recognized that project progress would depend entirely on the textile industry's acceptance and response to the sectoral program. Subsequent events demonstrated the irrelevance of a strict timetable approach.

5. Project Cost and Financing

5.1 Investment requirements in the sector, as reflected in the Bank's SAR, were estimated to be US$503 million for imported equipment and expatriate consultant services, between 1982 and 1985. The Bank loan was committed to supply US$150 million toward these costs, and available supplier's credits were to make up the difference. Local costs equivalent to about US$100.0 million were to be financed by the individual proponents of the subprojects.

5.2 Forecast and actual investments, in US$ million equivalent, in the textile industry were as follows:

	Forecast Investments	Actual Investments		
	Foreign & Local	Foreign Exchange Costs (C&F Value)	Working Capital and other Peso Costs	Total
1982-85	503	37	5	42
1986		22	3	25
1987-88		189	45	234
Total		248	53	301

The big increase in investments during 1987-88 was the result of the increased demand and confidence in the market and has been financed from private resources and through traditional commercial banking channels. Earlier, high interest rates, the experience of a rapidly depreciating Peso and the consequent high perceived foreign exchange risk had completely limited borrowing funded from the Bank loan. The experience in the subsector as well as in other industries of having borrowed funds subject to foreign exchange risks has caused firms to be reluctant to take up loans that are not protected against this risk.

6. Project Results

Despite the fact that the basic and major project component was never carried out, the project did produce some positive results. The extensive training program began to show definite signs that mills were making progress in improving quality and efficiency through the efforts of management and operations personnel who had participated in the training program. Also technical assistance in spinning, weaving, knitting, dyeing and finishing showed that some of the mills had acquired the capability to

produce fabric and yarn quality acceptable for the manufacture of export garments. These results of the technical assistance and training program enabled many of the mills to take advantage of the upturn in the domestic and export markets during the past two years (1987-88), especially as a result of changes in trade policies and incentives (see table on next page).

7. Status of Covenants

With deletion of the subproject component of the project, the pertinent covenants contained in the Loan and Project Agreements are no longer relevant. The covenants pertaining to the technical assistance and training retained in the project were fully complied with.

8. Use of Bank Resources

A. Staff Inputs

Staff inputs in carrying out the various tasks throughout the project cycle from preparation in 1980 to completion in 1989 were as follows:

Task	Input (Staff Weeks)
Project Preparation	45.0
Project Appraisal	70.7
Negotiations	4.7
Loan Processing /a	50.6
Supervision	44.9
Project Completion Report	3.0
Project Administration	14.2
Total	233.1

/a Staff weeks spent by former Programs Division. The high level of input reflects the complexity of the project.

Key Statistics for the Textile Industry 1979-88

	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988
A. PRODUCTION, TRADE & CONSUMPTION										
1. Local Production (000 MT)	115	96	96	81	88	76	71	89	119	121
2. Imports (000 MT)	35	27	26	33	14	12	16	14	21	25
3. Exports										
Direct Exports (000 MT)	10	13	13	9	6	6	6	0	5	5
Indirect Exports (000 MT)	1	2	3	2	2	4	6	17	37	43
Total Exports (000 MT)	11	15	16	11	8	10	12	17	42	48
4. Consumption (000 MT)	139	108	106	103	94	78	75	86	98	98
5. Per Capita Consumption										
Population (Million)	46.0	48.0	49.5	50.7	52.0	53.2	54.4	55.7	57.0	58.3
Per Capita Consumption (Kg)	3.0	2.3	2.1	2.0	1.8	1.5	1.4	1.5	1.7	1.7
6. Imports/Consumption (%)	25.2%	25.0%	24.5%	32.0%	14.9%	15.4%	21.3%	16.3%	21.4%	25.5%
7. Exports/Production (%)	7.9%	13.9%	15.1%	10.7%	8.5%	12.8%	16.0%	19.8%	42.9%	49.0%
B. EMPLOYMENT										
1. Textile Industry (000)	N.A.	96	85	72	77	71	70	70	70	86
2. Total Manufg. Empl. (000)	N.A.	1,850	1,780	1,888	1,822	1,847	1,926	1,763	2,054	2,198
3. Text.Ind./Tot.Manufg.(%)	N.A.	5.2	4.8	3.8	4.2	3.8	3.6	4	3.8	3.9
C. DATA FROM THE TOP THOUSAND COMPANIES (Textile Industry)										
1. # of Companies Included	13	13	14	14	14	14	15	19	21	N.A.
2. Sales (P Million)	1259.1	1342.6	2034.2	1941.4	2145.0	2790.1	3291.8	3267.8	4999.2	N.A.
3. Net Income (P Million)	-1.1	-59.9	-41.3	-63.0	-12.4	21.3	-22.4	40.6	194.6	N.A.
4. Assets (P Million)	1948.2	2385.4	3251.5	3275.3	3250.3	3371.0	3815.1	3439.3	5578.5	N.A.
5. Paid-Up Capital (P Million)	349.2	399.7	599.5	718.3	709.1	709.8	784.5	723.8	1377.0	N.A.
6. Return on Sales (%)	-0.1%	-4.5%	-2.0%	-3.2%	-0.6%	0.8%	-0.7%	1.2%	3.9%	N.A.
7. Return on Assets (%)	-0.1%	-2.5%	-1.3%	-1.9%	-0.4%	0.6%	-0.6%	1.2%	3.5%	N.A.
8. Return on Pd.-Up Cap.(%)	-0.3%	-15.0%	-6.9%	-8.8%	-1.7%	3.0%	-2.9%	5.6%	14.1%	N.A.
9. Pd.-Up Capit/Assets (%)	17.9%	16.8%	18.4%	21.9%	21.8%	21.1%	20.6%	21.0%	24.7%	N.A.
10.Total Manufacturing Output (P Billion)	52.1	64.6	75.2	83.1	95.2	137.3	150.5	154.7	173.5	201.8
11.Sales/Total Manufg.Outp.(%)	2.4%	2.1%	2.7%	2.3%	2.3%	2.0%	2.2%	2.1%	2.9%	N.A.

Sources: (1)"A Review of the Textile Sector with Proposed Plans and Strategies 1986-1995"
(2)"A Review of the Textile Sector with Proposed Plans and Strategies 1989-1995"
(3)"1000 Top Corporations in the Philippines"

AS2IE, 89/05/17

B. Missions

Stage of project cycle	Month Year	Number Persons	Days in Field	Speciali-zation b	Performance Rating /c	Type of Problem /d
Through Appraisal						
I	4/80	1	7	FA	-	-
II	10/80	4	7	E,FA,EC,C	-	-
III	3/81	3	15	E,FA,C	-	-
Supervision /e						
I	6/82	2	5	E, FA	1	-
II	12/82	2	5	E, C	2	PR,D
III	5/84	2	5	E, FA	3	D,COV
IV	7/84	2	15	FA, E	3	D,COM
V	6/85	1	5	E	3	D,COM
VI	11/87	1	5	FA	3	D,COM
VII	3/88	1	5	FA	3	D,COM
VIII	11/88	1	10	FA	3	D,COM

/b E = Engineering, FA = Financial Analyst, EC = Economist and C = Consultant.

/c 1 = No or minor problems, 2 = Moderate problems and 3 = Major problems which are being adequately addressed.

/d PR = Procurement, D = Disbursement and COM = Anticipated Completion.

/e Some of the supervision mission were combined with other business in the country. Three short follow-up visits were made to the Philippines during July 1987, November 1987 and March 1988, in the context of other business - reporting was in combined reports and in Form 590's.