INTERNATIONAL COTTON ADVISORY COMMITTEE
1629 K Street NW, Suite 702, Washington, DC 20006 USA
Telephone (202) 463-6660 • Fax (202) 463-6950 • e-mail secretariat@icac.org

GOVERNMENT MEASURES AND THE WORLD COTTON INDUSTRY[1]

Terry Townsend
Executive Director

The world cotton industry is in the midst of a prolonged change in prices as significant as the shift in the early 1970s when cotton prices doubled. Year-to-year changes in cotton production are determined by marginal production costs, not by average or total costs. Therefore, cotton prices tend toward the marginal costs of the most efficient producers, and marginal costs are falling. The consequence is higher production and lower average prices compared with the 1970s, 1980s and 1990s, and season averages of the Cotlook A Index are likely to be between 50 and 60 U.S. cents per pound most years this decade, 10 to 20 cents per pound lower than the average of the last thirty years.

The variable of greatest statistical significance in determining long run averages of the Cotlook A Index is the ratio of stocks to use outside China (Mainland). During the 15 years between 1986/87 and 2000/01, the non-China (Mainland) stocks-to-use ratio never exceeded 0.44 but rose to 0.55 in 2001/02 and is expected to remain above 0.50 through 2003/04. Slow growth in demand and rising cotton production are contributing to the rise in stocks as a percent of use.

Other things equal, a 20% decline in cotton prices leads to a 1% increase in world cotton use. The average price last season of 42 cents per pound was about 40% below the average of the last three decades. Therefore, even though world economic growth is still slower than in 1999 and 2000, cotton use is expected to climb about 2% to 20.6 million tons in 2002/03 and 1% more to 20.8 million tons in 2003/04. However, this growth is being induced by low cotton prices, not by an improvement in consumer preferences.

Faster growth in supply is another factor contributing to the rise in non-China (Mainland) ending stocks as a percent of use. Cotton infrastructure is expanding in Brazil and Turkey, and marginal production costs in both regions are substantially less than 50 U.S. cents per pound. Together, west Brazil and east Turkey are accounting for an additional 650,000 tons of world cotton production that did not exist in 1994/95.

Expanded use of genetically engineered varieties is lowering marginal costs and reducing risks in Australia, China, India and the USA. Cotton area planted to genetically engineered varieties rose from 2% of world cotton area in 1996/97 to 20% in 2001/02. About one-third of world cotton production was accounted for by GE varieties in 2001/02. GE technology will continue to spread and is forecast to account for half of world production by 2005/06.

Government Measures

Government measures that insulate producers from variations in market prices are contributing to the current imbalance between world cotton supply and demand. The level of direct assistance to cotton production provided by fourteen countries (Argentina, Benin, Brazil, China (Mainland), Colombia, Cote d'Ivoire, Egypt, Greece, India, Mali, Mexico, Spain, Turkey, and the

---

[1] Paper given to the 11th Australian Cotton Conference, 13-15 August 2002, Brisbane Convention and Exhibition Centre.

USA) rose from $3.8 billion in 2000/01 to $5 billion in 2001/02. An estimated 73% of world cotton production benefited in 2001/02 from direct income or price support programs, 14 percentage points more than in 2000/01.

The new U.S. farm bill ensures that the U.S. will remain a major producer and exporter of cotton through 2007/08. The new farm bill fixes the loan rate, which serves as a floor price for U.S. growers, at 52 cents per pound of current production. The bill also continues the practice of decoupled payments begun in 1996 by providing a guaranteed payment of 6.67 cents per pound and variable payments when market prices are below 72.4 cents per pound to land holders based on production history. Total direct assistance offered by the U.S. was $1.0 billion in 2000/01 and is estimated at $2.8 billion in 2001/02. In addition, indirect, or de-coupled assistance, provided by the fixed payments was worth approximately $1.3 billion in 2001/02. Total support to the cotton sector in 2001/02 was approximately $4.2 billion, equal to about $660 per planted hectare or 95 cents per kilogram of lint produced.

In Greece and Spain, growers obtain assistance through the Common Agricultural Policy of the European Union. Support payments of between 60 and 70 cents per pound are made to ginners who are required to pass the subsidy in the form of higher prices to growers. The maximum guaranteed quantity on which support is paid is 782,000 tons of seed cotton for Greece and 249,000 tons for Spain. Total direct assistance offered by the EU was $716 million in 2000/01 and is estimated at about the same level in 2001/02.

China (Mainland) provides direct price support to cotton growers by an informal process of guide prices communicated through the communist party structure. The guide prices serve as minimum prices to farmers and provide support of between 10 and 20 U.S. cents per pound of lint. Spending on cotton support by government agencies in China (Mainland) is estimated at $1.9 billion in 2000/01 and $1.2 billion last season.

In 2001/02, the Government of India for the first time in over a decade provided an estimated 9 cents per pound of emergency support to growers valued at $500 million, and nine other countries provided a cumulative $200 million in support to their growers.

Developments in the WTO

The venue for the negotiation of reductions in government measures that distort cotton production and trade is the World Trade Organization (WTO). An agreement to reduce subsidies that distort production and trade in agriculture will not be easy. Cotton is important to the history and culture of the USA, and cotton production is also important to farmers in Greece and Spain. Within the USA, cotton farming occurs in lower-income states and counties, often in areas where economic alternatives are not attractive. Even though half of direct benefits under the agriculture programs go to the largest 10% of growers, the impacts of farm spending on the regional economies of low-income states is substantial.

Likewise, areas of cotton production in Greece and Spain are categorized as the lowest-income regions within the European Union, and average cotton farm size in Europe is less than 5 hectares. Consequently, the EU sees the cotton income support program as a justified mechanism to help small, low-income producers with limited impact on the world cotton market. Both the U.S. and the EU argue that as net importers on a whole trade pipeline basis, each is actually helping to sustain the world cotton market.

Also, many countries provide support in the cotton sector, and many countries provide support to an estimated 160 agricultural commodities besides cotton. The issue of agricultural support is complicated by the existence of state trading organizations, the use of export credits and credit guarantees, tariffs and tariff rate quotas on agricultural products, food aid and other agricultural issues. Further, many countries impose tariffs on textile and apparel products, and the quotas under the Multi Fiber Arrangement (MFA) are still being phased out. Therefore, the negotiations to reduce government measures in cotton involve complex tradeoffs, and the mechanism to achieve reductions in trade distorting subsidies and tariffs is the talks on agriculture in the WTO. The WTO is the sum of the countries that participate in it. In order to advance the interests of agricultural trade liberalization, countries must unify and work effectively to articulate a positive program of mutual benefit within the talks on agriculture being conducted under the auspices of the WTO.

After six years of negotiations, members of the WTO launched a new round of multilateral trade negotiations in Doha, Qatar in November 2001. WTO Trade Ministers called for 1) the reduction, with a view to phasing out, of export subsidies, as well as 2) substantial improvements in market access and 3) substantial reductions in trade-distorting domestic support. While the start of a new round of trade talks is encouraging, there is a concern that the first goal of reducing export subsidies will take precedence over other considerations. Export subsidies are not as significant a source of distortion in the world cotton economy as they are in the grain and oilseeds markets. Therefore, the cotton industry is anxious to ensure that the goal of reducing trade-distorting domestic support must receive equal consideration with the goal of reducing export subsidies within the context of WTO negotiations.

Cotton is an important agricultural commodity, and the concerns of cotton merit attention in the WTO. The decline in cotton prices during 2001/02 led to direct losses of $14 billion in income to the cotton sector, and income from cotton provides money for school fees, rural transportation and health care for farm families in many developing countries. More than 100 million farming units are engaged directly in cotton production, and when family labor, hired on-farm labor, and workers in ancillary services such as transportation and ginning are considered, total involvement in the cotton sector reaches one billion people. Cotton cultivation contributes to food security and improved life expectancy in rural areas of developing countries.

The talks on agriculture within the WTO are proceeding in phases. Phase 1 during 2000 and 2001 consisted of 7 meetings and included 45 separate proposals from 121 countries. Phase 1 culminated at the November 2001 Doha Ministerial Conference in which the talks on agriculture were folded into the talks encompassing almost all the linked negotiations scheduled to end by January 2005.

The WTO talks on agriculture are now in Phase 2, which consists mainly of informal negotiations. The next informal session to discuss agricultural issues is scheduled for September 23-25, 2002. At these sessions in September, governments are being asked to table their proposals for the discussions on agriculture, and the U.S. made news at the end of July 2002 by tabling a proposal to eliminate export subsidies, reduce tariffs on agricultural products, and limit direct support spending (amber box) spending to a maximum of 5% of the value of agricultural production. Phase 2 is scheduled to conclude with a meeting during March 25-31, 2003. At that meeting, a Modalities Phase will begin during which negotiators will strive to set numerical targets to achieve the objectives set out in the Doha Ministerial Declaration.

Promotion Needed

The process of reducing government measures that distort the cotton market will take many years, and legitimate competitive market factors are also contributing to the decline in average prices. Therefore, countries must adapt to the realities of a change in market prices for cotton, and efforts to promote cotton use and to discourage government measures that encourage polyester use should be implemented.

Much attention has been focused on the role of the U.S. in distorting cotton production and trade, but there has been less attention given to the positive role of the U.S. cotton industry. The U.S. industry and government contribute more than $200 million per year in domestic and international cotton market development efforts. These efforts, begun in the 1950s, are now boosting world demand for cotton by two million tons per year. In comparison, in the absence of government measures, U.S. cotton production would be approximately 1.5 million tons lower. Therefore, objective estimates of supply and demand indicate that the net impact of the U.S. cotton industry on the world market, even with high levels of government support, is positive.

The WTO process involves tradeoffs and hard bargaining. There may be scope for compromise between the USA and other countries with the USA agreeing to reduce levels of government support for cotton production in exchange for sustained and vigorous efforts by other producing countries to boost demand for cotton. The work of *Cotton Australia* in representing the Australian cotton industry in a positive light and in providing positive information about cotton to consumers through the cotton store in Sydney are commendable activities that deserve expansion. If the Australian cotton industry were to expand demand enhancement activities proportional to the efforts of the U.S. industry, expenditures would reach A$15 million per year.

Internal Impacts of Subsidies

Much of the criticism of government measures focuses on the costs of subsidies and the potential for trade distortions, but subsidies also cause distortions within the countries that provide them. In the 1960s and 1970s, the U.S. ended the old programs based on acreage allotments and marketing quotas and implemented the current regimen of target prices and loan rates. Because of rising commodity prices in the 1970s, no program payments were made until 1982, but programs have been in force and payments have been made almost every year during the last two decades. There is now a generation of U.S. farmers who either have difficulty remembering or have no experience growing cotton without the influence of a government program.

In 1979/80, the average cost of producing cotton in the USA according to data collected by USDA was 59 cents per pound (excluding land costs and net of the value of cottonseed). Out of 22 countries participating in the survey that year, the U.S. had the eighth lowest cost of production, making the U.S. a relatively efficient, competitive cotton producer in an era when subsidies were not paid.

In contrast, by 1999/2000, the average cost of production in the USA, again using data from USDA, was 68 cents per pound, ranking the USA last among 18 countries participating in the survey. The survey of cost of production did not adjust for changes in exchange rates, and the rise in the value of the U.S. dollar between 1980 and 2000 helped to lower production costs in countries with depreciating currencies. Nevertheless, current data indicate that production costs in the USA rose between 1980 and 2000, while costs in many other countries fell. Neither Greece nor Spain participated in the cost of production survey in 2000, but available evidence is that costs of production in Europe are considerably higher than in any other country.

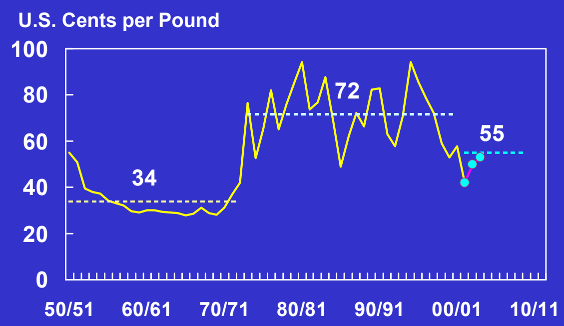
Over the last twenty years, under the influence of farm programs, yields in the USA have risen more slowly than in countries with dynamic cotton industries, including Australia, Brazil, China (Mainland) and Turkey. Also, U.S. costs of production have risen faster, and the USA is now an uncompetitive cotton producer dependent on continued government distortion of the cotton market to maintain its current share of world production. Subsidies paid to cotton farmers result in increased prices for land, machinery and other inputs used in cotton production, keep less-productive farmers in business, thus blocking better farmers from gaining control of land, and the whole political process needed to sustain votes in Congress for subsidies distracts American farmers from the crucial business of remaining competitive. With world production costs falling, the outlook for the USA under the new farm bill is for a further deterioration in underlying competitiveness and continued reliance on government intervention for market survival.

WTO Talks Key to Progress

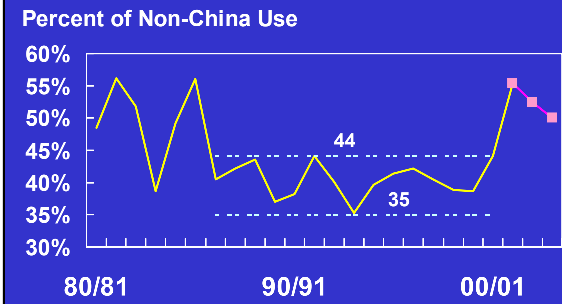
In summary, countries must make the talks on agriculture and the problems of the cotton industry a priority in their negotiations within the WTO. The cotton market is changing, with improvements in technology and the development of new cotton areas leading to reductions in marginal costs and an expansion in the world supply relative to demand. Countries must continue efforts to remain competitive through increases in yields and quality and reductions in costs. Producing countries can improve their market potential through the establishment of national programs to provide positive information to consumers about cotton.

As stated earlier, the WTO is the sum of the countries that participate in it. In order to advance the interests of agricultural trade liberalization, countries must work effectively to articulate a positive program of mutual benefit within the talks on agriculture being conducted under the auspices of the WTO. Given the importance of cotton to the livelihoods of approximately one billion people, the specific concerns of the cotton industry regarding production subsidies deserve the full attention of governments.

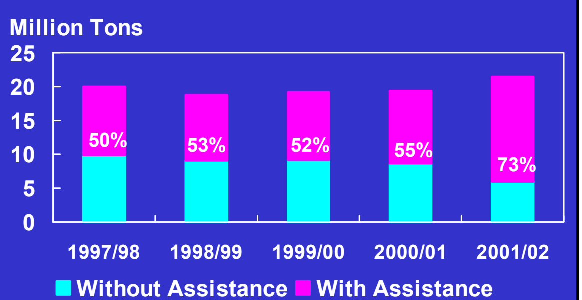
COTLOOK A INDEX



NON-CHINA (M) STOCKS



COTTON PRODUCTION



New U.S. Cotton Program

- Loan Rate (Price Support) 52.0¢
- Target Price (Income Support) 72.4¢
  - Fixed Payments 6.67¢
  - Variable Payments up to 13.73¢

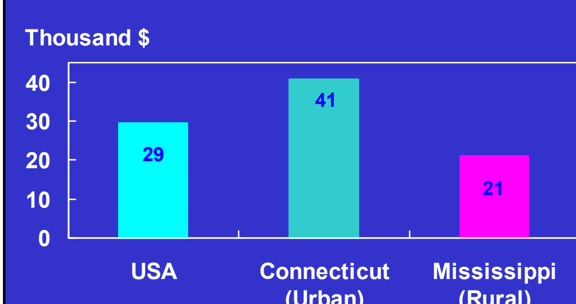
Impact: Production Sustained

2001/02 Support

- Greece 59¢/Lb.
- Spain 76¢/Lb.
- China (Mainland) 10¢/Lb.
- India 9¢/Lb.
- Nine Others 3¢ to 16¢/Lb.

Continued Support Expected

PERCAPITA INCOME

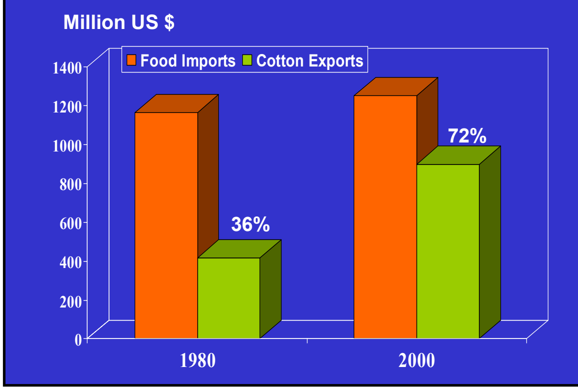


Doha Ministerial Declaration

1) **Reduce Export Subsidies**
2) **Improvements in Market Access**
3) **Reductions in Domestic Support***

*** Cotton Market Distorted Primarily by Domestic Support**

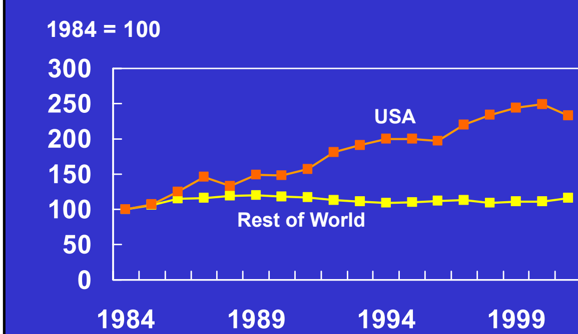
Cotton Exports & Food Imports: Africa



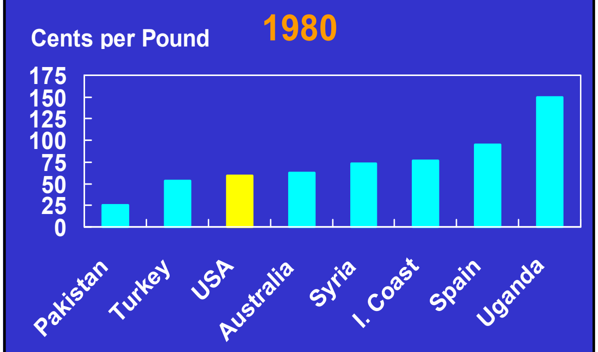
WTO Proceeding

1) **Phase 1: 2000 & 2001**
   45 Proposals
2) **Phase 2: ending March 2003**
   Informal Talks
3) **Modalities Phase: ending Jan. 2005**
   Numerical Targets

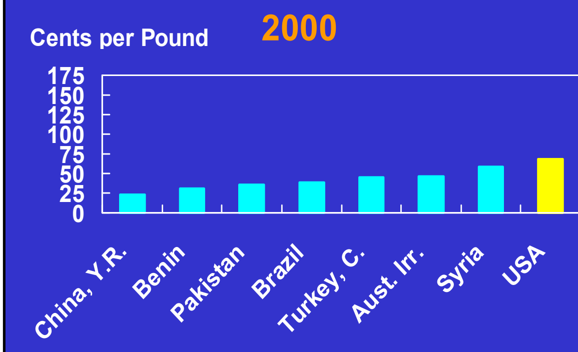
RETAIL COTTON CONSUMPTION



COST OF PRODUCTION: 1980



COST OF PRODUCTION: 2000



WTO Priority: Cotton

1) National Efforts:
   Efficiency, Demand Enhancement
2) WTO:
   Sum of Countries that Participate
3) Cotton affects 1 Billion;
   Deserves attention