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COMPETITIVENESS IN THE WORLD COTTON INDUSTRY*

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Market Forces Drive Prices Lower

The price of cotton is tending downward over the long run. This is a phenomenon common to many primary commodity industries and results naturally and inevitably from market forces in a competitive world economy. During the first four seasons of the 1980s, the Cotlook A Index, an indicator of average world cotton prices, averaged 83 cents per pound. During the first four seasons of the 1990s, the average world price fell to 69 cents, and during the first four seasons of this decade, average prices will be about 56 cents. If inflation is considered, cotton prices in real terms have been falling since the 1950s. The ICAC Secretariat estimates that average cotton prices are likely to be between 50 and 60 U.S. cents per pound this decade, 10 to 20 cents per pound lower than the average of the last thirty years.

Three fundamental market factors are influencing shifts in the level of world cotton supply and demand: 1) improved technology, 2) the development of new cotton areas, and 3) competition with polyester. In addition, government measures that distort production and trade force the burden of adjustment to lower prices onto producers in countries that cannot afford subsidies.

Technology

The most visible of the new technologies is genetic engineering. GE varieties already account for 21% of world cotton area and about one-third of world production and trade. GE is the most rapidly adopted technology in the history of agriculture. The primary impact of GE varieties is not higher yields, although some farmers record higher yields. Instead, the technology is primarily risk-reducing and cost-reducing, leading to larger area and greater production. The most significant impact of the Bt varieties that provide bollworm resistance has been in China (Mainland). Production in East China, affected in the early 1990s by resistance among bollworms, climbed about 300,000 tons between 1999/00 and 2000/01 largely because of the adoption of Bt varieties, and GE varieties in China are now planted on 60% of cotton area. GE varieties account for about 30% of area in Australia, three-fourths of area in the USA, and field trials are underway in other producing countries. GE cotton varieties will probably account for half of world production by 2007.

Incremental advances in proven technologies such as irrigation management, pesticide formulations and pesticide applicators, low till and no till production systems, crop rotations and other management techniques are also contributing to lower production costs and expanded cotton production.

New Area

The development of new areas for cotton in Brazil, Africa and Turkey are contributing to the rise in world production. Production costs in Mato Grosso are estimated well below the world average, and production has climbed from 30,000 tons to 600,000 tons in Mato Grosso since the mid-1990s. Production in the Currency of Francophone Africa (CFA) zone of Africa has approximately doubled

* A statement by the Executive Director of the ICAC before the 36th World Farmers' Congress, May 29 – June 4, 2004, Washington, DC, sponsored by the International Federation of Agricultural Producers

since 1994. The expansion of irrigation in East Turkey is well documented, and the GAP region now accounts for 500,000 tons of production, compared with 164,000 tons in 1994/95 when the Cotlook A Index averaged more than 90 cents per pound. Together, Mato Grosso, the CFA zone of Africa and East Turkey are accounting for an additional 1.4 million tons of world cotton production representing 7% of the world total that is still expanding and that did not exist in 1994/95.

Polyester

Competition with polyester is an insidious challenge to the cotton industry that is accelerating as fiber production technology results in lower costs of polyester production and an increased range of uses for chemical fibers. Cotton’s share of world fiber use exceeded 60% in the 1960s, fell to 50% during the 1980s and currently stands at 39%. While cotton use is rising in absolute terms, the rate of increase averages just 1% per year, compared to world population growth of 1.7% per year, resulting in reduced consumption per capita and declines in market share. Research by the ICAC indicates that the rate of increase in world cotton mill use declines by approximately 1% for every increase of about 6 cents per pound in the price of cotton relative to prices of competing fibers. As the cost of production of polyester has fallen to less than 50 cents per pound mill-delivered in the past ten years, cotton prices are being forced lower over the long run in order to compete.

Government Measures Distort

Measures by governments to support farmers and domestic production during periods of economic stress affect the distribution of world cotton supply, without necessarily expanding supply in the long run. The Secretariat estimates that U.S. cotton production would be reduced by about one-fourth in the absence of the U.S. cotton program, and production in the EU would probably drop by three-fourths without the income support program. China (Mainland) is also known to support domestic prices above market levels, and a withdrawal of subsidies would probably result in a significant decline in production. Mexico, Brazil, Egypt and Turkey also have modest programs that support cotton farmers. In the absence of government measures, world production would still be large enough to satisfy demand, but the location of production would shift from countries that provide subsidies to countries that do not. Further, during years of declining prices, the responsiveness of supply to reduced demand would be greater in the absence of government measures, meaning that the reductions in supply necessary to balance demand during years of slow economic growth would be spread over all countries rather than just among those subject to market forces.

Outlook for 2004/05

Within a long term trend of declining real prices and average prices of between 50 and 60 cents per pound forecast for this decade, the cotton industry is currently experiencing strong demand linked to record imports by China (Mainland) resulting in relatively attractive prices for producers. However, production will respond to current high prices, resulting in lower prices over the next several years.

World consumption in the current season (2003/04) is leveling off at 21.1 million tons. IMF projections released in April suggest that world GDP will grow about 4.5% in 2004 and next year, and world cotton consumption is projected to climb to 21.3 million tons in 2004/05, up only 200,000 tons (1%).

Net imports by China (Mainland) are skyrocketing from 680,000 tons in 2002/03 to an estimated 1.85 million tons this season, the highest ever. Because of the strong imports, the average Cotlook A Index is expected to be 71 cents per pound in 2003/04, compared with 58 cents last season. China (Mainland) is expected to import 1.5 million tons in 2004/05, down 350,000 tons from the current season, but still substantial.

The rise in prices this season is leading to increased world production in 2004/05. Planting in the Northern Hemisphere is now largely completed. World cotton area is expected to rise by 6% to 34 million hectares in 2004/05, up 2 million hectares from this season and the highest since 1995/96. The world yield is estimated at 644 kilograms per hectare in 2004/05, 9 kilograms higher than in 2003/04. Based on these assumptions, world production is forecast at 22.1 million tons, up 1.6 million tons from this season, and the second largest crop on record.

With production expected to exceed mill use in 2004/05, world ending stocks are projected to climb. The Cotlook A Index is expected to average 65 cents per pound in 2004/05, down six cents from the average anticipated for the current season. The projected 6-cent decrease is the result of falling net imports by China (Mainland) and rising stocks in the rest of the world.

Developments in the WTO

An unprecedented aspect of the current round of world trade talks is the emphasis on cotton. Cotton is unusual in being both a labor-intensive crop in developing countries and a capital-intensive crop in developed countries. Even though government measures in cotton constitute approximately 1% of all support to agriculture in OECD countries, it is commonly thought that the talks in Cancún unraveled over cotton.

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 Greece, Spain and the USA. Within the U.S. and Europe cotton farming occurs in lower-income regions, often in areas where economic alternatives are not attractive. Consequently, there is a long chain of political support for cotton among landowners, cotton input suppliers and small-town merchants with vested interests in continued cotton production. 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. The EU is the largest import market for textiles in the world, and the U.S. is the largest retail market for cotton. The U.S. industry and government contribute approximately $60 million per year in domestic and international cotton market development efforts. These efforts, begun in the 1950s, are boosting world demand for cotton, perhaps by more than subsidies boost U.S. production.

Future Action

Producers need to respond to the inevitable long run declines in cotton prices with strategies that expand the demand for cotton, facilitate the adoption of competitive technologies and reduce government measures that distort production and trade. In particular there are five areas of activity in which the support of farmers and the IFAP can be of benefit to the world commodity economy.

1) In order to strengthen the market for cotton, the ICAC is encouraging all countries to require fiber content labels in all textile products sold at retail. There is abundant research showing that when consumers are aware of fiber content, they consistently choose cotton products. However, only 59 out of 166 countries recently surveyed have laws requiring that fiber content be labeled in products sold at retail. Consequently, many consumers are not able to readily identify the fiber content of products offered for sale in their countries, thus inhibiting efforts to boost retail level demand for cotton. The support of IFAP for this initiative by helping the ICAC to communicate this need to governments can help to boost demand for cotton.

2) Improvements in cotton quality and quality measurement are components of an overall strategy of improved cotton industry competitiveness. There is an emerging international consensus that instrument-based quality evaluation systems are superior to traditional hand-classing methods for cotton, but these systems are expensive and involve the operation of complex instruments in air-conditioned environments with trained personnel. The ICAC is working to assist developing

countries with the adoption of new cotton classing technologies to enable them to compete in the international marketing of cotton, and the endorsement of this initiative will be very helpful.

3) Input supply to smallholder cotton producers is important for increasing cotton production in developing countries. Cotton is a relatively input-intensive crop, requiring certified planting seeds, quality fertilizer and appropriate insecticides applied using the latest approaches in integrated pest management to optimize yields and improve profitability. A constraint to increased production is a lack of accessibility to inputs by small holders. A number of international initiatives are underway to address this problem, including efforts funded by UNCTAD, FAO, The World Bank and the Common Fund for Commodities (CFC). There are also national programs to increase the availability of inputs. A theme common to all the projects is the strengthening of capacity in the private sector to provide quality inputs to small holders, and producers attending this World Farmers' Congress can endorse these efforts.

4) Institutional support for the ICAC, and other International Commodity Bodies (ICB's), can also help to strengthen commodity markets. It is a harsh reality that in a liberalized world economy, some governments are questioning the importance of commodity industries and re-evaluating the worth of membership in international commodity bodies. The ICAC was created in 1939 with a mission of assisting governments to facilitate a healthy world cotton economy. Together with UNCTAD, the CFC and sister ICB's, we work to raise awareness of commodity problems, to provide scientific and statistical information critical to decision making and to facilitate cooperation between governments and industry segments on issues of shared concern. The support of producers in encouraging governments to maintain their memberships in ICB's can be of significant benefit to commodity economies.

5) Finally, the most constructive effort the international community can make at this time is to ensure that the talks on agriculture are a priority in negotiations within the WTO. At its most recent plenary meeting in Poland in September, the ICAC strongly supported a successful outcome to the talks on agriculture and other topics being conducted under the auspices of the WTO. The overwhelming majority of member governments reaffirmed the negative impacts of subsides and other government measures on cotton production and trade affecting cotton farmers, especially in the developing and least developed countries, and urged that all government measures and subsidies on cotton be removed. Producers and producer organizations can advance the interests of agricultural trade liberalization by articulating a positive program of mutual benefit within the talks on agriculture being conducted under the auspices of the WTO.

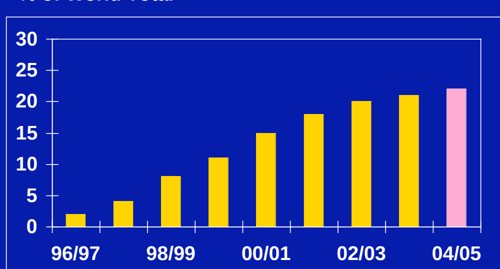
International Cotton Advisory Committee

COTLOOK A INDEX

Cents per Pound

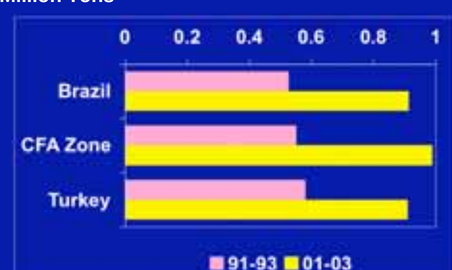
GE COTTON AREA

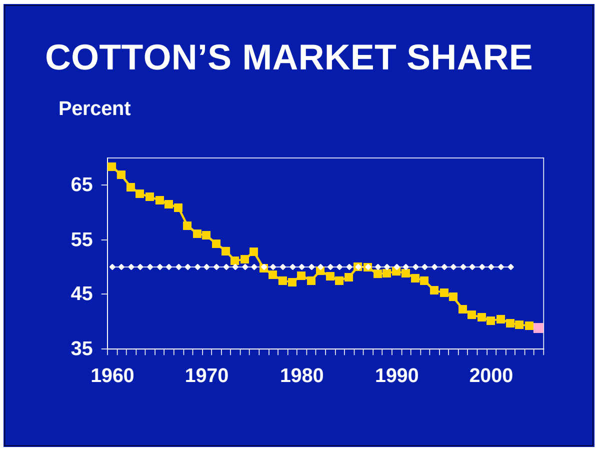
% of World Total

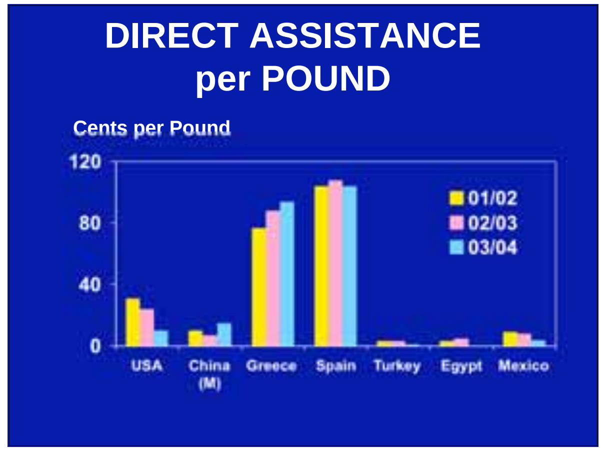


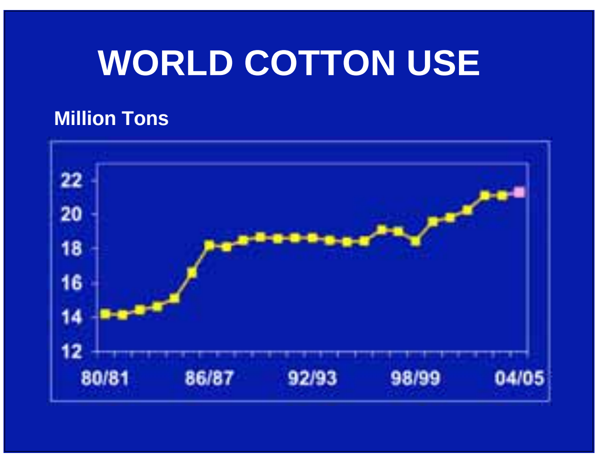
COTTON PRODUCTION

Million Tons

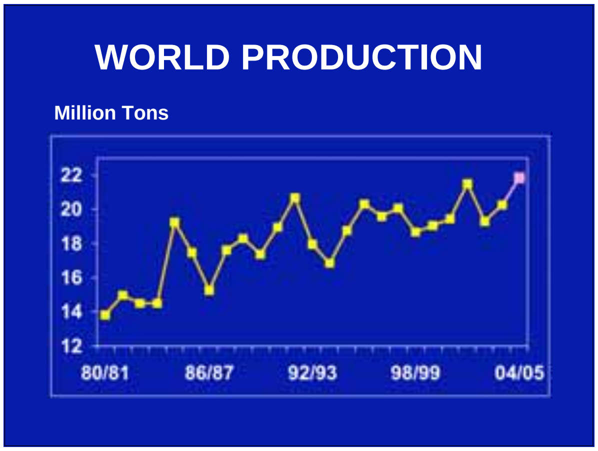


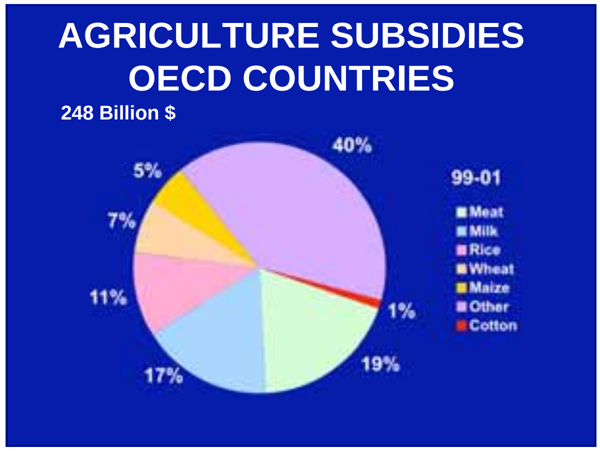

COTTON'S MARKET SHARE
Percent
65
55
45
35
1960
1970
1980
1990
2000

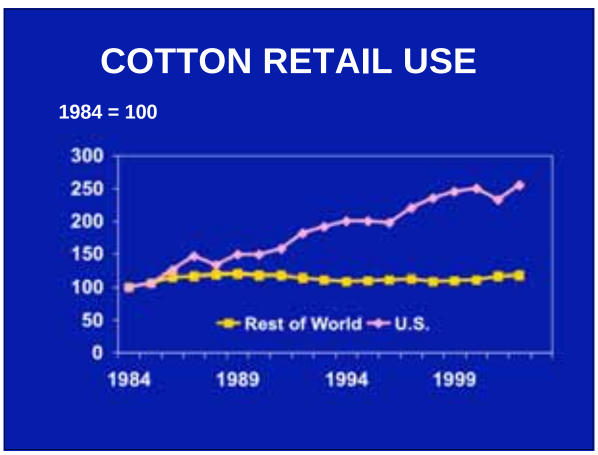

DIRECT ASSISTANCE per POUND
Cents per Pound
120
80
40
0
01/02
02/03
03/04
USA
China (M)
Greece
Spain
Turkey
Egypt
Mexico

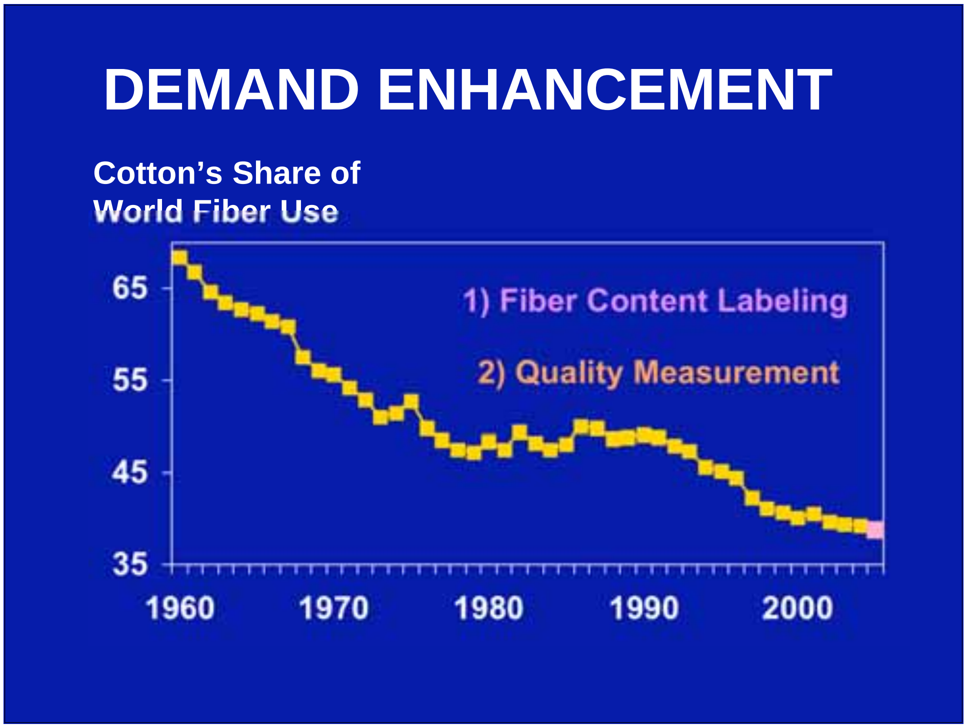

WORLD COTTON USE
Million Tons
22
20
18
16
14
12
80/81
86/87
92/93
98/99
04/05


PRICES & CHINA (M) TRADE
1,000 Tons
Cents/Lb.
2000
1000
0
-1000
-2000
100
90
80
70
60
50
40
30
Net Expts
A Index
80/81
90/91
04/05


WORLD PRODUCTION
Million Tons
22
20
18
16
14
12
80/81
86/87
92/93
98/99
04/05


AGRICULTURE SUBSIDIES
OECD COUNTRIES
248 Billion $
40%
5%
7%
11%
17%
19%
1%
99-01
Meat
Milk
Rice
Wheat
Maize
Other
Cotton


COTTON RETAIL USE
1984 = 100
300
250
200
150
100
50
0
Rest of World
U.S.
1984
1989
1994
1999


DEMAND ENHANCEMENT
Cotton's Share of
World Fiber Use
65
55
45
35
1960
1970
1980
1990
2000
1) Fiber Content Labeling
2) Quality Measurement

COSTS OF COTTON PRODUCTION: 2000

Cents per Pound

4) SUPPORT INTERNATIONAL COMMODITY BODIES

Assist Governments to Facilitate Healthy Commodity Economy

- Raise Awareness
- Provide information
- Facilitate Cooperation

5) SUPPORT WTO TALKS

1) Reduce Export Subsidies

2) Improve Market Access

3) Reduce Domestic Support

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