



INTERNATIONAL COTTON ADVISORY COMMITTEE

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Memorandum 810

To: Delegates to the Standing Committee, Coordinating Agencies, Members of the Private Sector Advisory Panel and Members of the International Forum for Cotton Promotion

From: Executive Director

Subject: Correction to Memorandum 805: Impact of the Elimination of Step 2 Payments

Date: September 28, 2006

The U.S. Step 2 program for Upland Cotton expired on July 31, 2006. The Secretariat issued Memorandum 805 in mid-July about the impact of the elimination of Step 2. There was an error in Memorandum 805.

The Secretariat stated in Memorandum 805 that as a result of the elimination of Step 2, *the difference between average farm prices in the United States and the loan rate will widen, resulting in larger Loan Deficiency Payments to U.S. growers than would otherwise be the case.* This statement was in error.

The Secretariat confused movements in the U.S. farm price with movements in the Adjusted World Price (AWP). Loan Deficiency Payments are calculated as the difference each week between the loan rate and the AWP, not the difference between the loan rate and U.S. farm prices. Since the AWP is based on quotes published in Cotton Outlook for cotton from many origins delivered to North Europe adjusted for transportation costs and quality differences, changes in U.S. farm prices are only indirectly linked to changes in the AWP. In fact, it is possible that as a result of the elimination of Step 2, the AWP could rise even as U.S. farm prices fall, resulting in smaller Loan Deficiency Payments to U.S. growers. Memorandum 805 incorrectly indicated that the elimination of Step 2 will automatically result in increased payments from other components of the U.S. farm program.

The Secretariat believes that other conclusions in Memorandum 805 are valid. The Secretariat believes that the quantity of cotton supplied to the rest of the world by the United States is not likely to change, and therefore the elimination of Step 2 is not expected to have a significant impact on international cotton prices. There is an expectation in the United States that the elimination of the Step 2 payments will result in lower domestic prices paid to U.S. farmers (perhaps in the magnitude of a few cents per pound).