

## U.S. Cotton Market & Price Risk Management

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## FAS Mission

- **Promote U.S. agricultural exports**
  - market intelligence and research
  - market promotion and development
  - export credit and finance programs
  - market access / trade policy interventions
- **Global food security**
  - food aid and long-term credit programs
  - technical assistance

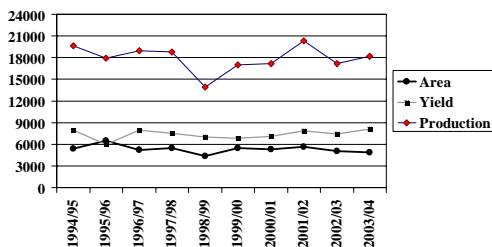
## Goals of USDA's Economic Intelligence System

- **Objectivity**
  - Not biased by financial or political interests.
- **Reliability**
  - Based on sound data and analysis
- **Timeliness**
  - Quick, predictable flow to users; principle of equal access.

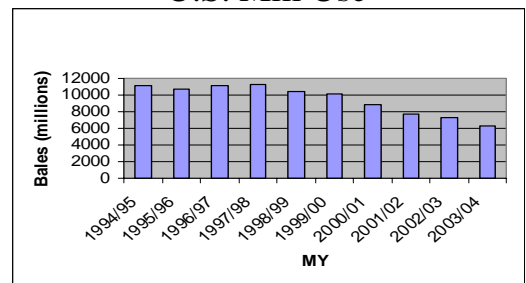
## Interagency Commodity Estimates Committees

- **Draw on all relevant expertise within USDA.**
- **Construct country and global supply-demand estimates.**
- **Ensure accuracy and consistency.**

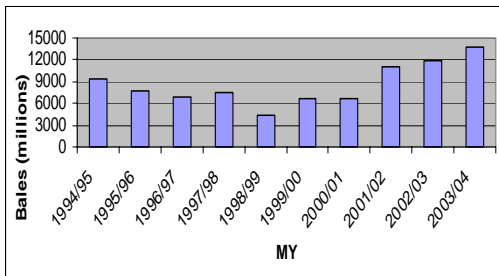
## US. Cotton Production, Area and Yield



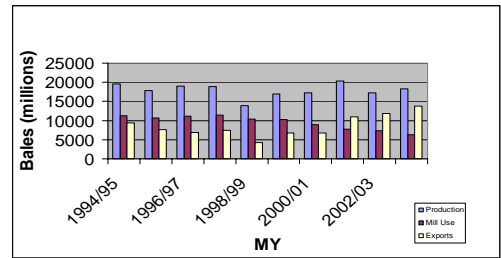
## U.S. Mill Use



## U.S. Cotton Exports



## U.S. Cotton Supply and Demand



## Price Risk Management

- A. Infrastructure Protection
- B. Private Risk Management Tools- Futures/Options Markets
- C. Industry Structure
- D. U.S. Government Programs
- E. Crop Insurance

## A. Infrastructure Protection

- Sanctity of Contract
- Quality information
- Information system
- Warehouse receipt system

## B. Futures/Options Markets

- A futures contract is an agreement to buy/sell in the future a specific quantity of a commodity (ie., cotton) at a specific price.
- An option on a futures contract gives the buyer of the option the right to convert the option into a futures contract

## Futures /Options continued

- The Commodity Futures Trading Corporation's mission is to protect market participants against manipulation, abusive trade practices and fraud

## C. Industry Structure

- Cotton Cooperatives
  - Nearly 50 percent participation of cotton farmers
  - Market and sell the cotton for farmers which eases producer burden
  - Cooperative has many functions

## D. U.S. Government Programs

- Commodity Credit Corporation Loan Program –CCC Loan
- Farm Income Protection Program
- Step 2 Payments
  - These programs are transparent and carried out following strict formulas. This guarantees that government programs are not affecting the market.

## CCC Loan

- The only program that is tied to current production
- The current loan rate is set at \$.52/lb. (base quality)
- If cotton sells for above \$.52/lb, the loan is repaid at \$.52/lb.
- If cotton sells below \$.52/lb, the loan is repaid at the lower rate. Farmer keeps the difference.

## Farm Income Protection continued, Direct Payments

- Payments not tied to current production, rather tied to historical area and yield
- Target price set at \$72.4/lb
- Direct payment set at .067/lb
- Price and payments set by law

## Farm Income Protection continued, Counter-Cyclical Payments

- Provided price dependant benefits whenever the effective price is below the target price
- Does not provide benefits for reduced yields, higher prices
- Also based on historical yields and area

## Farm Income Protection continued, Counter-Cyclical Payments

- A CCP payment is made when the higher of the loan rate or the effective price is below the target price minus the direct payment rate

## An Example.....

- Target Price=72.4 cents/lb.
- Direct payment =6.7 cents/lb
- Loan rate=52 cents/lb.
- Effective Price=64 cents/lb
- CCP = 72.4 (Target Price)- 6.7 (direct Payment) – 64 cents/lb.
- CCP= 1.7 cents/lb

## Farm Income Protection continued, Step Two Payments

- Payments are made to exporters and domestic mills
- Payments are measured using a formula which measures the difference between the lowest U.S. quotes in Northern Europe & the average of quotations for the five lowest price international growths, basis Northern Europe

## E. Crop Insurance

- Yield Based Insurance Coverage
- Revenue Insurance Plans

## Yield Based Insurance Coverage

- Actual Production History- Insures against natural disasters
- Group Risk Plan- provides indemnity when yields are below a county index
- Dollar Plan- provides protection against declining value due to damage which causes shortfall

## Revenue Insurance Plans

- Group Risk Income Protection- Provides indemnity payments if avg county revenue falls below revenue chosen by farmer
- Adjusted Gross Revenue- Insures revenue of entire farm, rather than single crop.
- Crop Revenue Coverage- Provides revenue protection based on price and yield expectations.