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
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 (i.e., 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

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 that single crop.
• Crop Revenue Coverage- Provides revenue protection based on price and yield expectations.

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