11:30 hr. Wednesday, September 22, 2010
Dr. Gary Adams, Vice President for Economics and Policy Analysis, National Cotton Council of America, in the Chair.

The CHAIR recognized the delegate of TOGO, who asked a question related to the 3rd open session. The delegate of Togo asked for a definition of the “Cotton Made in Africa” label, and which countries this label relates to. The Secretary General replied that he would communicate the question to appropriate persons for a response.

The CHAIR observed that current the market situation is drastically different from the situation a year earlier, with prices now exceeding a dollar per pound. He said that this situation presented an interesting background for a discussion of the outlook for cotton.

The CHAIR introduced Mrs. Armelle Gruere and Dr. Alejandro Plastina to present a report from the ICAC Secretariat on the outlook for cotton supply and use. The report indicated that after declining for three consecutive years, world cotton production is expected to rebound by 16% to 25 million tons in 2010/11, encouraged by the significant rise in prices experienced the previous season. They reported that world cotton mill use should also continue to recover, but more slowly than in 2009/10 due to limited available supplies and high prices, to 25 million tons. As production and consumption are forecast to roughly balance in 2010/11, world ending stocks are expected to remain stable at 9 million tons. World cotton trade is forecast to continue to increase by 8% to 8.4 million tons, driven by larger Chinese imports. The United States will account for most of the increase in exports this season as a result of lower competition from India.

They indicated that as consumption of chemical fibers started recovering in 2009, while cotton consumption was still subdued, the market share of cotton declined for the third consecutive year to 36.5%. The Secretariat forecasts a further decline in the share of cotton in world fiber consumption to 35.7% in 2010, and to 35.0% in 2011. The projected decline of cotton’s share in world textile fiber consumption is the result of an expected faster recovery of non-cotton fiber than of cotton fiber consumption in 2010 and 2011, partly influenced by an increase in prices of cotton relative to prices of competing fibers.

According to the Secretariat, the season-average Cotlook A Index is expected to continue to increase by 14% to 89 cents per pound in 2010/11, with a 95% confidence interval ranging from 76 cents per pound to 103 cents per pound. This would be the highest season-average since 1994/95. According to the Secretariat, the current increase in cotton prices seems to be driven mostly by market fundamentals, rather than speculation. However, external factors such as the uncertain global economic outlook, possible government measures affecting global cotton trade, and price competition with other fibers could affect the degree of increase in prices in 2010/11.

The CHAIR called on Dr. Rafiq Chaudhry of the Secretariat to make his presentation on the cost of production. Dr. Chaudhry stated that the ICAC Secretariat undertakes a survey of the cost of cotton production at three-year intervals. In 2009/10, 34 countries participated in the survey. The sample was divided into six groups: North America, South America, Asia, West Africa, other Africa and Australia. Dr. Chaudhry said that the average net cost of production of seed cotton increased from U.S.$0.34 per kilogram in 2006/07 to $0.43 per kilogram in 2009/10. The average cost of production of cotton lint (net of land rent and the value of seed) increased from $1.04 per kilogram to $1.22 per kilogram over the same period. Lower yields were the main drivers of the rise in
unit production costs. The cost of production of cotton lint varied among regions from $0.91 per kilogram in African countries other than West Africa to $1.96 per kilogram in North America. In Asia and West Africa, the net cost of production of cotton lint was $1.15/kg.

Dr. Chaudhry reported that the average cotton farmer over the entire sample spent $0.08 per kilogram of cotton lint production on planting seed, $0.14 on insecticides, $0.28 on fertilizer, $0.28 on weed control (hoeing, thinning, inter-culturing/weeding and chemical weed control), and $0.10 on irrigation in 2009/10. Insecticide costs remained stable, but fertilizer costs increased by $0.06 and weed control costs more than doubled between 2006/07 and 2009/10. The Fruitful Rim region of the USA, followed by Colombia and China, had the highest costs of production of cotton lint in 2009/10, exceeding $2 per kilogram. India, whether irrigated or rainfed, had the lowest production costs of cotton lint because of recent increases in yields and high values for seed. The value of cottonseed in India is 3 to 4 times greater than the cost of ginning.

Dr. Chaudhry indicated that despite the 250 kilograms per hectare difference in yields in favor of irrigated areas (63% of world cotton area), the average net cost of producing a kilogram of lint under irrigated conditions ($1.40) was higher than under rainfed conditions ($0.93) in 2009/10. The average net cost per hectare under irrigated conditions was $1,231 compared to US$679 under rainfed conditions.

The CHAIR introduced Mr. Andreas Engelhardt from Oerlikon Textile International to speak about the outlook for polyester. Mr. Engelhardt indicated that the global supply of manmade fibers (synthetics and cellulose fibers) and major natural fibers (cotton, wool, and silk) has increased at a 3.3% rate per year since 2000, reaching 70.6 million tons in 2009. During this period, the share of manmade fibers increased from 59% to 63%, while the share of cotton declined from 38% to 36%, and the share of polyester increased from 36% to 45%.

According to Mr. Engelhardt, the widening gap in prices between cotton and polyester has already resulted in shifts to polyester in spun yarn manufacturing. Given the significant excess capacity of polyester, in particular in China, the potential for a sustainable higher price level of polyester appears to be limited. Therefore, it seems most likely that comparatively low polyester prices will lead to declining cotton prices. Simultaneously, a downswing in cotton prices will directly affect prices of acrylic and cellulosic fibers. An additional burden in cellulosics comes from considerable investments for expansion in the Chinese market.

According to Mr. Engelhardt, global fiber consumption is expected to continue its long term trend, favoring polyester consumption over cotton consumption. The production of polyester fibers is projected to increase from 32 million tons in 2009 to 47 million tons by 2020, at an annual average growth rate of 3.8%. The expected growth in polyester production is substantially faster than the expected growth in cotton production. Mr. Engelhardt said that two often-cited potential limitations for polyester production are high crude oil prices and the finite nature and instability of fossil fuel supplies. However, the impact of oil prices on prices of raw materials used in polyester production (paraxylene, purified terephthalic acid, and monoethylene glycol) has often been overrated, according to Mr. Engelhardt. Furthermore, technological change should reduce the global dependence on oil and relax the second limitation to polyester production.

The delegate of INDIA said that high price volatility could mean that the fundamentals of cotton supply and use presented by the Secretariat underestimate the degree of supply shortages. He suggested that the work of the Secretariat should be reviewed by economists to suggest areas for improvement in forecasts of supply, use and prices. He indicated that policy makers in India must balance the markets and interests of 60 million workers. He pointed out that price volatility in China is much lower than in India and that prices of $1.10 per pound are not viable for textile units in India. He suggested a meeting between consuming and producing countries during the plenary meeting to discuss price volatility and ways to achieve market stability, and he suggested that additional meetings should be convened quarterly. He suggested that the plenary meeting should agree on appropriate guidelines for stocks-to-use ratios in major countries.

The delegate of ARGENTINA supported the statement by India on the need for a study on volatility and observed that the Argentine delegation presented a document about the negative effects of price volatility to the Plenary back in 1989. The delegate asked Mr. Engelhardt to comment on the amount spent on research by the chemical fiber industry.
Mr. Engelhardt replied that he was unable to provide figures of spending on research and development in the industry because such information is proprietary within each company. He added that recycling of man-made materials is of increasing interest worldwide and that about 3 million tons of polyester are produced from recycled plastic bottles in China alone.

The delegate of ARGENTINA asked Mr. Engelhardt to indicate trends in per capita consumption of polyester in the least developed countries with high levels of poverty. Mr. Engelhardt said that manmade fiber production is capital intensive, however some emerging markets such as Vietnam are expanding their capacities. He said production capacity in Vietnam increased from zero to 200,000 tons in a year. Dr. Plastina commented that the Secretariat issues an annual report on world textile demand, which indicates that with rising incomes polyester consumption rises faster than consumption of cotton for low-income countries. He added that as per capita incomes rise to the levels of middle and upper income countries, consumers have more discretionary income and demand for cotton improves.

The delegate of ARGENTINA congratulated Dr. Chaudhry for his report on the cost of production, indicating that income in rain-fed cotton production is higher than in irrigated production. However, the delegate pointed out that this should not be interpreted as a policy suggestion for governments, since weather risks associated with rain-fed production may justify investments in irrigation. The Secretariat agreed with the delegate that differences in rain-fed and irrigated incomes in a single season should not be interpreted as a policy suggestion. It was noted that because cotton is drought tolerant it is often grown in arid conditions, and that irrigation from ground water sources may be necessary to maintain yields.

The delegate of MALI said that producers in African countries closely monitor price fluctuations and production depends on the level of prices. He indicated that the current positive evolution of prices could allow Mali to implement privatization of the industry successfully. He asked how long the current trend would continue and whether prices are expected to decline in the near future. The Secretary General said that cotton prices could not remain high for long periods. He indicated that every time prices had reached 90 cents per pound during the previous four decades, they had declined during the next season.

The delegate of PAKISTAN asked the Secretariat to comment on the impacts of the rising cost of production, high volatility of cotton prices and competition between cotton with polyester on producers, consumers and others in the cotton value chain. The CHAIR suggested that delegates are in a better position than the Secretariat to comment on these issues.

The delegate of BRAZIL noted that forecasts for cotton prices made a year ago proved to be too low. He asked the Secretariat to comment on what we know today that we did not know a year ago that explains the current level of high prices. He also asked why highly environmentally unfriendly polyester production is acceptable to consumers while cotton is criticized for its impact on the environment, and he asked whether polyester is sustainable. Dr. Plastina replied that a year ago IMF predictions did not indicate that the world economy would recover as rapidly as it has. He noted that the resulting strengthening in demand for cotton was the primary factor that has resulted in prices higher than those expected one year ago. He added that other factors, such as weather in some countries and policy decisions related to trade have also affected prices. Mr. Engelhardt replied that there is no alternative to polyester unless the world is willing to devote additional millions of hectares to cotton production. He estimated that the world would need to plant an additional 40-50 million hectares to cotton to replace polyester. He said that polyester is sustainable in the sense that there is no foreseeable limit on the supplies of the petrochemicals needed to produce it.

The delegate of PAKISTAN expressed concerns about the market interventions restricting exports implemented by India in order to protect its domestic textile industry. He said that interference in trade brings uncertainty and distortions to the international market. He reiterated concerns that had been voiced in 2009 in Cape Town that in a closely integrated cotton economy, countries need to avoid the use of protectionist measures. He said that it is well understood that protectionist measures lead to uncertainty, volatility, and distortions to trade.

The delegate of POLAND summarized research showing that natural fiber apparel and bedding promote better health and rest. She pointed to the need to promote the positive effects of cotton on a human body and the negative effects of polyester.
The delegate of NIGERIA urged the Secretariat to carefully examine the results of its cost of production study indicating higher net incomes in rain-fed areas in comparison with irrigated areas. He pointed to effects of Bt cotton introduction in India leading to higher yields.

The delegate of CAMEROON asked the Secretariat to supplement the information provided on price volatility and price projections with information on the evolution of exchange rates, for example the changes in the rate of the U.S. dollar to the euro. The Secretary General noted that information on exchange rates is available in the Secretariat’s written reports. Mrs. Gruere said that we cannot make projections for exchange rates fluctuations, but she showed a chart portraying trends in the price of cotton expressed in various currencies.

The delegate of SUDAN suggested that more information on price fluctuations of other commodities, especially food commodities, should be provided so that it helps cotton producers to make better planting decisions. He asked if the increased price volatility could affect the 95% confidence interval in the ICAC price model results. He also asked the Secretariat to comment on the cost of production of Bt cotton in comparison to conventional cotton. Mrs. Gruere replied that the Secretariat monitors fluctuations of prices of competing commodities, and the Secretariat consider the price ratios of these commodities to cotton at the time of planting of significant importance in estimating changes in area. She noted that the projected increase in cotton production next season could lead to lower prices. Dr. Plastina said that the ICAC price model was introduced in 2008 and the first year projections were just 4 cents per pound off the actual. During the succeeding years the difference between projections and actual prices widened significantly because of unforeseen developments, such as the economic recession and succeeding faster than expected recovery. He said that the model explained 85% of factor variability initially, but now this percentage has declined to 82%, and he agreed that additional study of factors affecting cotton prices is necessary. Dr. Chaudhry replied that the cost of production using cotton varieties with biotech traits could be lower than the cost of conventional cotton production in some countries, the same as conventional cotton production in other countries, or even higher than conventional cotton production in other countries. He noted that some farmers are using biotechnology only for environmental reasons.

The delegate of COLOMBIA noted that China has the highest cost of cotton production and the most competitive textile industry, and she suggested that that paradox could only be explained by the undervalued Chinese currency. She suggested that the Secretariat should make an effort to provide ratios of exchange rates of producing and consuming countries. She noted that there is a substantial difference between rain-fed land in Brazil and rain-fed areas in sub-Saharan Africa in terms of productivity.

The delegate of INDIA suggested that a volatility model should be looked at as a crash in cotton prices could happen. He proposed that the Secretary General should convene a special meeting between producing and consuming countries during the plenary meeting to discuss the issue of price volatility. He also urged the Secretariat to monitor price volatility closely. The Secretary General assured delegates that the Secretariat monitors volatility of cotton prices closely. He said that he would meet with the delegate of India and the Chair of the Standing Committee to discuss the possibility of a special session devoted to price volatility.

The delegate of the USA noted that market transparency is the key to lower price volatility. He said the U.S. supports the role of the ICAC in providing objective information. He said the USDA is also provides a wide range of market information which serves to lower market volatility. He said the U.S. supports the statement by the delegate of Pakistan against market interference by governments that restrict cotton trade, thus contributing to price volatility.

The delegate of EGYPT suggested that the Secretariat should closely monitor per capita consumption of cotton and of other fibers. The delegate expressed his view that speculation in the cotton market is contributing to price volatility, and he suggested that the Secretariat should study this matter further.

The delegate of INDIA responded to the delegate of the USA, saying that price volatility requires government intervention and that government officials must balance competing interests when making policy decisions.
The CHAIR thanked the members of the Panel for their presentations, and he thanked participants for the excellent discussion.

The CHAIR adjourned the meeting at 13:55 hours.