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PRODUCTION AND TRADE POLICIES AFFECTING THE COTTON INDUSTRY

October 2012

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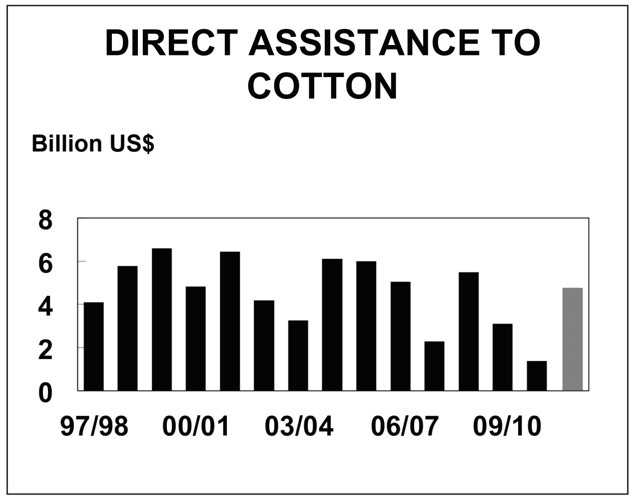
A report by the
Secretariat of the
International Cotton Advisory Committee

Washington DC, USA

GOVERNMENT SUPPORT TO THE COTTON INDUSTRY

Subsidies to the cotton industry, including direct support to production, border protection, crop insurance subsidies, and minimum support price mechanisms are estimated at $4.8 billion in 2011/12 up from $1.4 billion in 2010/11. Ten countries provided subsidies in 2011/12, and the subsidies averaged 17 cents per pound, up from 5 cents per pound on average in 2010/11. More countries have cotton production support programs, but because of high prices the programs did not result in actual spending in 2011/12.

Lower market prices for cotton in 2011/12 led to an increase in subsidies paid to producers. The Cotlook A Index averaged 100 cents per pound during 2011/12, and 164 cents per pound in 2010/11. However, prices in 2011/12 were still well above long-term averages, and government interventions in a number of support programs in several countries were not triggered. Pakistan, Mexico and India have minimum support price programs, but because market prices were still higher in 2011/12, these programs did not result in payments to producers. However, if prices were lower these programs would be effective.



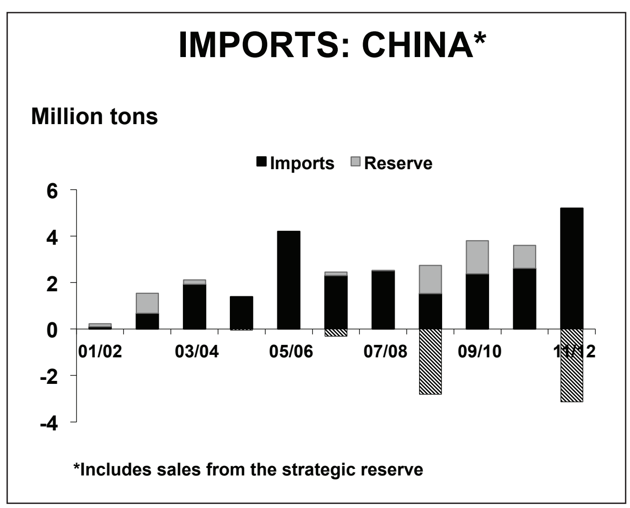
The share of world cotton production receiving direct government assistance, including direct payments and border protection, increased from an average of 55% between 1997/98 and 2007/08, to an estimated 84% in 2008/09. During 2009/10 through 2011/12, the share averaged 49%. Since 1997/98, there is clearly a negative correlation between the Cotlook A Index and the amount of subsidy provided to the world cotton industry, as well as the number of subsidizing countries.

Some countries provided subsidies for cotton inputs in 2011/12, especially for fertilizers, storage, transportation, classing services and other marketing costs.

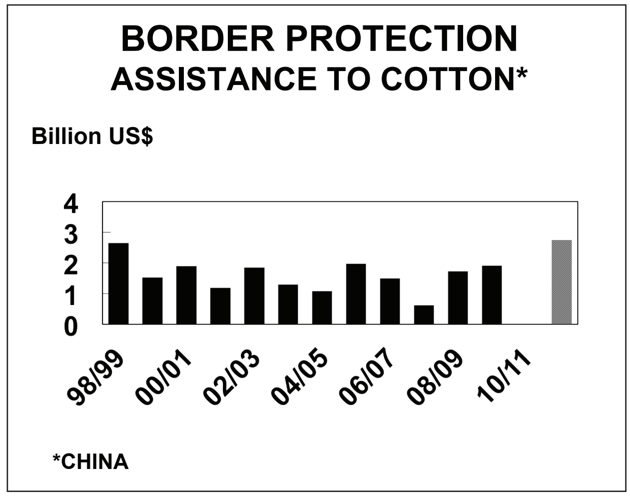
China

Government policies in China support cotton production by exercising border protection based on sliding scale duties or direct purchases by the government for reserves. Both measures were exercised during 2011/12. As a result of government interventions and quotas, domestic cotton prices in China were above international prices.

Under the terms of its accession agreement into the WTO, China is obliged to establish a calendar year tariff-rate-quota (TRQ). The in-quota tariff is 1% for the first 894,000 tons of imports each calendar year. Additional import quotas are released by China based on requirements. The additional quotas can carry a tariff of 1%, or quotas can be based on a sliding scale of between 5% and 40%. The purpose of the sliding scale is to ensure that the effective cost of imported cotton exceeds international market prices and thus boosts domestic prices paid to farmers in China.



The Secretariat uses the difference between domestic and imported cotton prices as an estimate of the support to Chinese cotton prices that results from government interventions. The price differential between the CC index (an index of mill delivered cotton in China) and the FC Index L (an index of imported cotton arriving in Chinese main ports), adjusted to include the value added tax, port charges and transportation to mills is used in calculations.



The usual TRQ of 1% for 894,000 tons was released for calendar year 2011. In addition, the government opened an additional TRQ of 1.7 million tons, under a sliding scale duty going up to 40%. A fixed rate duty of 570 Yuan per ton applied for imported cotton priced above 11,397 Yuan per ton[1]. International cotton prices averaged well above this threshold during 2011 (A Index averaged 164 cents per pound in 2010/11). As a result, duties on imported cotton in 2010/11 were fixed at 570 Yuan per ton, representing about 2% of import costs. China imported 2.6 million tons of cotton during 2010/11. Domestic cotton prices in China stayed below international levels beginning in mid-December, 2010. Because world cotton prices were record high in 2010/11, the border protection measures used by China had no measurable impact on domestic cotton prices.

A TRQ of 1% for 894,000 tons was released for calendar year 2012. In addition, the government opened an additional TRQ of 2.1 million tons, under a sliding scale duty going up to 40%. The threshold below which the sliding scale duty takes effect was raised from 11,397 yuan per ton to 14,000 yuan per ton[2]. Above the threshold, a fixed rate of duty of 570 yuan per ton applies. The Cotlook A Index averaged $1.00 per pound during 2011/12. As a result, duties on imported cotton in this period likely averaged around 4%. China imported an estimated 3.5 million tons during January-July 2012. It is not known if and when the government of China will issue new import quotas, and if and when it will release some of the large quantities of cotton it accumulated in the national reserve between October 2011 and March 2012. The China National Cotton Reserve Corporation (CNCRC) is the agency that manages the state reserve. The estimate of benefits resulting from border protection measures in China received by producers in 2011/12 was about US$2.7 billion, or 17 US cents per pound of production.

China maintains significant strategic reserves of cotton. China releases cotton to the market through a system of auctions when there is a shortage, the government replenishes the reserves when there is an abundance of supplies and prices are low. During the past decade, the largest sales of government reserves were made in 2009/10 (1.4 million tons) and in 2010/11 (1 million tons). Large purchases for the state reserve of 2.8 million tons were made in 2008/09. Release of the reserves to domestic mills reduces the need for imports and limits growth in world trade, while purchases for the reserve boost domestic prices in China and increase world trade.

In 2011/12 China implemented a minimum cotton support price combined with the rebuilding of the national reserve. The state reserve procurement price for 2011/12 was set at 19,800 yuan per ton (Type 328)[3]. For 2012/13 the procurement price was increased to 20,400 yuan per ton[4]. China purchased for the strategic reserve 3.1 million tons of domestic cotton and about one million tons of imported cotton during 2011/12. This resulted in a significant increase in world imports in 2011/12 and supported domestic and international prices. It is estimated that the national reserve in China holds 4.5 million tons. It is likely that at some point in the future this cotton from the reserves will be auctioned to the spinning mills in China.

In addition, the government of China pays growers a subsidy for using high-quality planting seeds, about $180 million a year. During the past two seasons China provided subsidies for transportation of cotton from Xinjiang to mills in east and south China estimated at about $150 million per year.

All types of subsidies totaled an estimated $3.1 billion in 2011/12, up from $330 million in 2010/11.

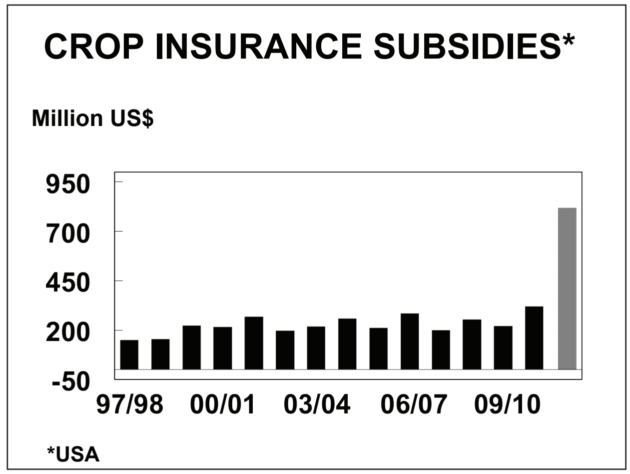
The Ministry of Finance (MOF) in China paid about $290 million during the first half of 2011 to pay for the interest on loans that were given for agricultural projects benefiting cotton, grain and vegetable oil processing.

1) Respectively: 4 cents and 80 cents per pound at the exchange rate of July 1, 2011.
2) $1.00 per pound at the exchange rate of end-July, 2012.
3) $1.41 per pound as of end-July, 2012.
4) $1.45 per pound as of end-July, 2012.

United States

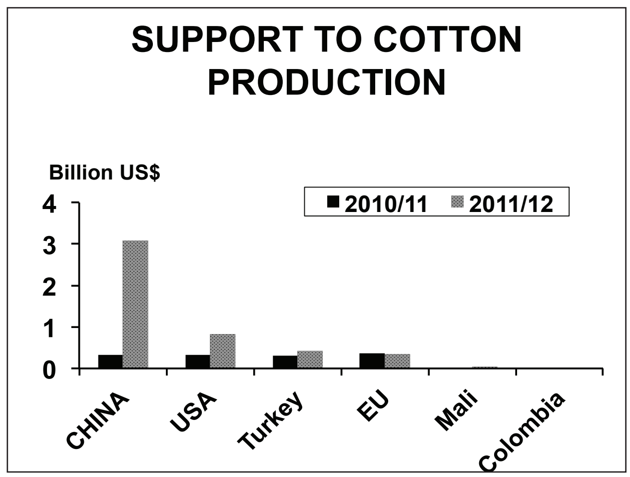
During 2010/11 and 2011/12, the only subsidy received by producers under the U.S. cotton program was for crop insurance. All other subsidies were not available because of historically high market prices.

The U.S. cotton program supports producers through several mechanisms: a direct payment (DP), a counter-cyclical payment (CCP), a loan deficiency payment (LDP), certificate exchange gains, marketing loan gains and crop insurance. The CCP and LDP were unavailable during the current and the previous seasons.



U.S. cotton producers received about $580 million in direct payments (DP) during 2011/12. The DP, which is independent of market prices and is based on historical planted area and yields, is set at 6.67 cents per pound. The DP (income aid) is decoupled from current production and is not counted as a subsidy to production.

The U.S. government provides support to cotton production through subsidized crop insurance to protect producers against losses to crop yields caused by natural disasters. Nearly every cause of decline in crop yields is covered by this multi-peril crop insurance, such as weather, pests, and fire, but not producer negligence. The insurance is sold to farmers, largely through private insurance providers, but USDA's Risk Management Agency (RMA) pays more than half of the premiums. Additionally, the RMA pays the private insurance providers for their administrative and operating costs, plus the RMA's own administrative costs under the program. On average, more than 90% of planted cotton acreage is enrolled in the program.



The crop insurance program is statutorily mandated to be actuarially sound, meaning that over time total premiums are supposed to cover total indemnities. During the past 14 years, the premiums exceeded indemnities in 1997, 2004, 2005, 2007 and 2010. Underwriting gains and losses are allocated between the companies and government according to formulas contained in the reinsurance agreement between the parties.

Total premium subsidies averaged $220 million per year between 1997 and 2009. In 2010/11 total crop insurance subsidies are estimated at $319 million, or 3.7 cents per pound of total production and rose to an estimated $819 million in 2011/12 (11 cents per pound). The increase was caused by higher insurance premiums tied to the increased value of the crop because of higher market prices.

During 2010/11 and 2011/12, no payments under the U.S. Pima competitiveness program were made because prices for competing foreign growths remained relatively high.

India

India has a Minimum Support Price program, but because market prices were high in both 2010/11 and 2011/12, this program did not result in payments to producers. An increase of 29% in the minimum support price in India for medium staple cotton for 2012/13 to Rs. 3,600 per 100 kg of seed cotton (up from Rs. 2,800), an equivalent of 84 cents per pound of lint at the exchange rate as of end of July 2012, could result in large purchases of domestic cotton by the government Cotton Corporation of India (CCI) during 2012/13.

In 2010/11, the Indian government restricted exports of cotton to about 1.1 million tons. Without the restriction, India could have both exported and imported cotton in 2010/11.

Cotton exports from India were unrestricted between August 2011 and the end of February 2012. However, on March 5, 2012, the commerce ministry banned new exports of cotton, including cotton already registered for exports, as a measure of support for domestic mills. The reason for this ban lies in the significant amount of cotton shipped in the first five months of the Indian cotton season (October 2011 to February 2012) and fears that the quantity remaining in the country would not be sufficient for the needs of domestic mills. On March 9, 2012, it was clarified that the ban was not applicable to cotton for which Let Export Orders (LEOs) had been issued up to March 4, 2012. On March 12, 2012, the government announced that the cotton that had already been registered for export up to March 4, 2012, would be allowed to ship after revalidation of the registration contracts. However, no new export registrations were allowed[5]. In addition, the process to revalidate export registrations, announced on March 16, 2012, brought delay to the shipment of registered cotton contracts. In fact, India produced a record crop while domestic mill use weakened. The ban was completely lifted on April 30, 2012. As a result, Indian exports in 2011/12 are estimated at a record 2 million tons.

The 2010 and 2011 Indian restrictions on exports caused a large number of Indian firms not to perform their contracts, a disruption of trade, losses to many of the Indian and international merchants, and resulted in an increase in the number of arbitration cases at the International Cotton Association (ICA) and undermined India's reputation as a reliable trading partner. It is possible, that the 2012 short-time export ban could have similar effects.

Cotton farmers in India benefit from debt forgiveness and fertilizer subsidies from the government of India. In addition the Government of India provides support to cotton production through several programs, such as development of infrastructure facilities for production and distribution of quality seeds. Under the government's Technology Mission, support was provided for modernization of ginning and pressing units and for improving cotton marketing during the past several years. These benefits are difficult to quantify, and some are not specific to cotton. In addition, the government supports the textile sector with a number of programs that provide direct support and soft loans.

European Union

Changes were introduced in the EU Common Agricultural Policy (CAP) starting in 2009/10. As before, cotton producers receive 65% of EU support as a single decoupled payment (income aid) and the remaining 35% as an area payment (coupled, or production aid). Greece and Spain are the major cotton producers in the EU. For production aid the maximum base eligible areas were reduced and are now set at 250,000 hectares for Greece and 48,000 hectares for Spain. To be eligible for the aid the area must be located on agricultural land authorized by the EU member states for cotton production, sown under authorized varieties and actually harvested under normal growing conditions. The aid is paid for cotton of sound, fair and merchantable quality. The aid is paid per hectare of eligible area by multiplying fixed reference yields by the reference amounts fixed for each country. For the purpose of calculation of aid, the seed cotton yield per hectare is fixed at 3.2 tons per hectare for Greece and at 3.5 tons per hectare for Spain. The amounts per hectare are fixed at euro 251.75 for Greece and euro 400 for Spain. If the eligible area exceeds the maximum base area, the aid per hectare is reduced proportionally.

It is estimated that in 2011/12 the amount of direct subsidy to production in Greece was $266 million ($280 million in 2010/11) resulting in 43 US cents per pound of lint production (70 U.S. cents in 2010/11). The subsidy in Spain is estimated at $89 million ($93 million in 2010/11), or 67 US cents per pound of lint (98 U.S. cents in 2010/11).

Turkey

The government of Turkey pays a premium per kilogram of seed cotton to producers (the premium is higher for seed cotton produced from certified seeds). The premiums for 2011/12 remained unchanged from the previous two seasons and are 0.42TRL/kg for seed cotton produced from certified seeds (26 US cents per kg) and 0.35TRL/kg for seed cotton produced from regular seeds (22 US cents per kg). Assuming that 90% of Turkish cotton production is

5) Newsletter from Cotton Association of India, March 13, 2012.

produced from certified seeds, and that all cotton producers applied for the premium, the Secretariat estimates that total payments to cotton producers in Turkey rose from $302 million in 2010/11, to $428 million paid in 2011/12 as a result of increased planting.

Brazil

Brazil operates a marketing program providing direct subsidies to producers based on guaranteed prices, but without direct acquisition of cotton by the government. The program is called the Equalizer Price Paid to the Producer (PEPRO – Prêmio Equalizador Pago ao Produtor). The PEPRO was used for several seasons to compensate farmers for the weakening US dollar in relation to the Brazilian real. The premium paid under the program represents the difference between the minimum-guaranteed price and the price the buyer is willing to pay. The minimum-guaranteed price is set at R$ (Brazilian real) 44.60 per arroba (15 kg) of lint, or an equivalent of 66 cents per pound at the exchange rate prevailing at the end of July 2012. The actual size of the premium is determined at auctions organized by the government. There have been no auctions since 2009/10. During the past 2 seasons market prices were high, while the Brazilian real weakened in relation to the dollar.

The government of Brazil also provides support to cotton production through subsidized credit for production, marketing and investments. It is estimated that subsidized annual credit to cotton producers averaged around half a billion U.S. dollars during the past decade. Low-income cotton growers receive subsidized interest rate of 5%, compared with market rates of 20-25%. Based on the difference, it is estimated that the maximum annual subsidy received by cotton growers in a form of subsidized interest averaged $75 million during the past decade.

Colombia

In Colombia, direct government payments to producers in 2011/12 are estimated at $26 million, averaging 26 cents per pound. In 2010/11 direct government payments were estimated at $9 million averaging 11 cent per pound.

West Africa

Several countries in West Africa provided subsidies for cotton inputs in 2010/11 and 2011/12, especially for fertilizers, and planting seeds. In 2011/12, Mali provided $38 million (9 cents per pound); Côte d'Ivoire $14 million (11 cents per pound); Burkina Faso $5.7 million (0.4 cents per pound); and Senegal $3.5 million 93 cents per pound).

Registration of Cotton Exporters by the Government of China

The General Administration of Quality Supervision Inspection & Quarantine (AQSIQ) of China established a requirement for a registration process for foreign cotton suppliers effective March 15, 2009. The major concerns are that the system unfairly subjects suppliers to different levels of inspection and oversight, potentially based on a single infraction, and the registrations may damage the reputation of foreign suppliers through the publication of downgraded ratings. The potential disruption in trade from this system could be compounded by quality assessment methods for imported cotton diverging from those used internationally or used by China for domestic cotton.

Twenty lists of registered companies have been published by AQSIQ. As of the beginning of May 2012, 511 companies were registered with the AQSIQ. The list of registered companies includes major and small cotton firms from North America, South America, Asia, Africa, Europe and Australia, from all major exporting countries, including government owned firms, private and cooperative organizations.

Level of Direct Assistance Provided by Governments to the Cotton Sector Through Production Programs *

Country	2010/11			2011/12 **		
	Production	Average Assistance per Pound Produced	Assistance to Production	Production	Average Assistance per Pound Produced	Assistance to Production
	1,000 tons	US cents	US$ Millions	1,000 tons	US cents	US$ Millions
Burkina Faso	645	0	6	694	1	10
China	6,400	2	331	7,400	19	3,077
Colombia	35	11	9	41	28	26
Cote D'Ivoire	59	15	20	59	11	14
Greece	180	70	277	280	43	266
Mali	103	9	20	187	9	38
Senegal	46	3	4	50	3	4
Spain	43	98	93	60	67	89
Turkey	450	30	302	750	26	428
USA	3,942	4	320	3,391	11	819
All Countries	11,904	5	1,380	12,911	17	4,770

* Income and price support programs only. Credit and other assistance not included. ** Preliminary.

Total Level of Assistance Provided by Governments to the Cotton Sector Through All Programs *

	Production	Average Assistance per Pound Produced	Assistance to Production
	1,000 tons	US cents	US$ Millions
1997/98	20,181	9	4,108
1998/99	18,810	14	5,772
1999/00	19,194	16	6,588
2000/01	19,524	11	4,833
2001/02	21,667	13	6,446
2002/03	19,574	12	4,193
2003/04	21,132	7	3,270
2004/05	26,997	10	6,114
2005/06	25,668	11	6,008
2006/07	26,766	9	5,045
2007/08	26,073	4	2,292
2008/09	23,455	11	5,492
2009/10	22,170	6	3,098
2010/11	25,103	2	1,380
2011/12**	27,089	8	4,770

* Income and price support programs only. Credit and other assistance not included.

** Preliminary.