INTERNATIONAL COTTON ADVISORY COMMITTEE

Discover Natural Fibres Initiative

# PRODUCTION AND TRADE POLICIES AFFECTING THE COTTON INDUSTRY

September 2010

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A report by the
Secretariat of the
International Cotton Advisory Committee

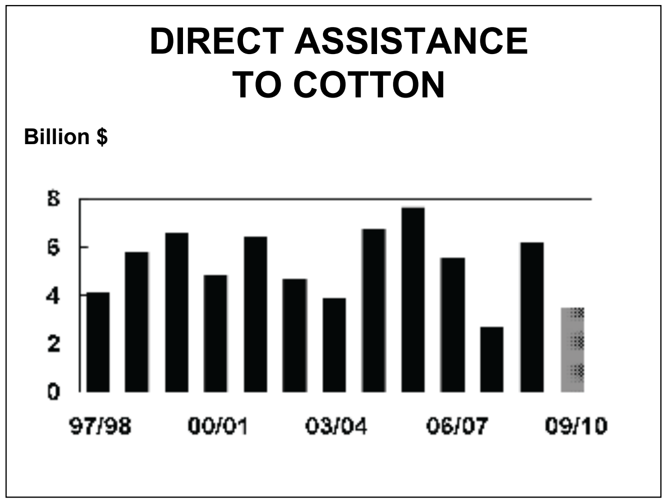
Washington DC, USA

# GOVERNMENT SUPPORT TO THE COTTON INDUSTRY

Subsidies to the cotton industry, including direct support to production, border protection, crop insurance subsidies, minimum support price mechanisms and export subsidies, are estimated at $3.5 billion in 2009/10 down from $6.2 billion in 2008/09. Seven countries provided subsidies in 2009/10, and the subsidies averaged 13 cents per pound, down from nine countries providing 14 cents per pound on average in 2008/09.

The major reason for the decline in subsidies during 2009/10, compared with 2008/09, was the sharp increase in market prices. The Cotlook A Index averaged 61 cents per pound during 2008/09 and 78 cents per pound in 2009/10. As a consequence, government expenditures on a number of support programs in several countries declined.

In addition, several countries in Africa and Asia announced subsidies for cotton inputs, especially for fertilizers for 2008/09 and 2009/10. Some governments subsidized storage, transportation, classing services and other marketing costs in 2008/09.




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 the share declined to 52%. 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.

The level of direct government assistance provided through export programs is estimated to have decreased from $400 million in 2005/06 to $30 million in 2007/08, and to an estimated $10 million in 2008/09 due to reduced production of extra-fine cotton. During 2009/10, the U.S. Pima competitiveness program is estimated at $30 million of export subsidies, while the 2008/09 Indian subsidies of 5% of the FOB value of exports was not renewed during 2009/10.

## United States

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.

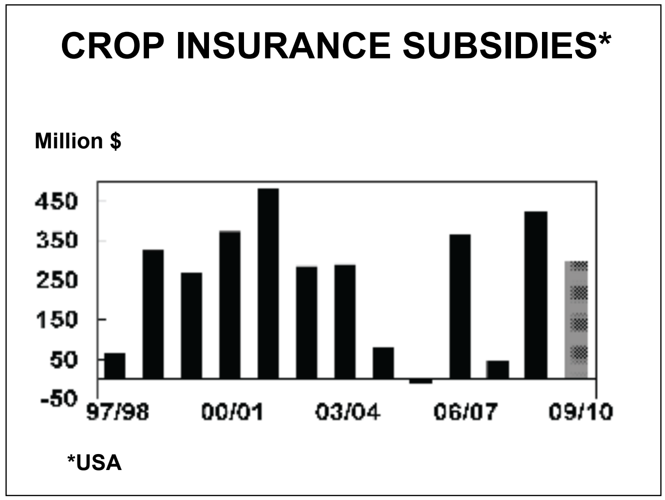
The DP, which is independent of market prices and is based on historical planted area and yield, is set at 6.67 cents per pound. It is estimated that in 2009/10 the DP was $587 million ($593 million in 2008/09). The CCP, which is also based on historical planted area and yield, is paid when the effective price is below the target price (71.25 cents per pound or 1.15 cents lower than under the previous farm bill)[1]. The CCP was available to eligible farmers for a short period during the first half of 2009/10 and is estimated at $152 million ($1,225 million in 2008/09).

The LDP is paid when market prices (the adjusted world price or AWP) are below the loan rate (52 cents per pound). The AWP stayed above the loan rate during 2009/10, resulting in zero LDP ($71 million in 2008/09).

1) The effective price is the DP plus the higher of the national average market price paid to producers or the loan rate.

In addition, producers are able to buy commodity certificates at the rate of the adjusted world price (AWP) and exchange them on the same day for cotton pledged as collateral to the Commodity Credit Corporation (CCC) for a commodity loan. Realized gains from the certificate exchange, called certificate exchange gains, equal the amount by which the loan rate exceeds the AWP. Certificate exchange gains are similar to the LDP. The certificate exchange gains were estimated at zero in 2009/10 ($830 million in 2008/09).

Producers also may receive gains called marketing loan gains, or loan write-offs, if the loan repayment rate is less than the loan principal. Marketing loan gains were estimated at $6 million in 2009/10.




Another form of government support to cotton production in the USA is provided 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.

By design, the crop insurance program is supposed to be actuarially sound, meaning that over time total premiums are supposed to cover total indemnities. In practice, however, during the past 13 years, the premiums exceeded indemnities only in 1997, 2004, 2005 and 2007. The net losses (indemnities over premiums) fall upon the government because it reinsures the privately marketed policies. The net losses are added to the premium subsidies to calculate a total cost of crop insurance to the government.

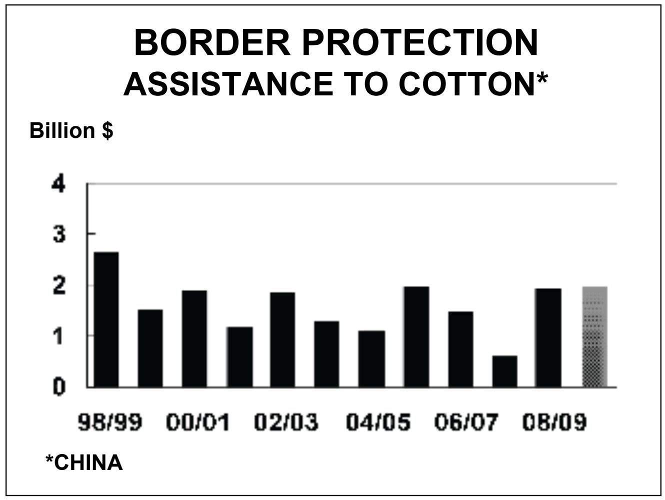
Total premium and indemnity subsidies averaged $254 million per year between 1997 and 2009, with the highest cost of $482 million paid in 2001. The government received $9 million in 2005 when the unsubsidized part of premiums exceeded premium subsidies and indemnities. Total crop subsidies fluctuated from 0.5 cent per pound of total production to 7 cents per pound during the past 12 years. In 2009/10 total crop insurance subsidies are estimated at $297 million ($423 million in 2008/09), or 6 cents per pound of total production.

Total U.S. support to cotton production, including crop insurance subsidies, declined from $3.2 billion in 2008/09 to an estimated $1.1 billion in 2009/10. Support in 2008/09 was equivalent to 52 cents per pound of production and declined to an estimated 19 cents per pound during 2009/10. During the past 11 years, the highest U.S. direct support to cotton production of $3.9 billion was provided in 2004/05, an equivalent of 35 cents per pound of production that season.

## China

During the past several seasons, government policies in China supported cotton production by exercising border protection based on sliding scale duties or direct purchases by the government for reserves. As a result of government interventions and quotas, domestic cotton prices in China were above international prices.

The Chinese government did not use the sliding-scale cotton import quotas in 2008/09. Instead, in order to support producer prices, a Chinese government agency, the China National Cotton Reserves Corporation (CNCRC), purchased 2.724 million tons of cotton, or a third of 2008/09 production. The cotton purchased for the government reserve was bought at a base procurement price of 12,600 yuan/ton for Type 328 (equivalent to 84 US cents/lb as of the end of July, 2009). In 2009/10, the sliding-scale import quotas were used again, providing support to domestic prices.




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, averaged 10.8 US cents per pound in 2009/10 (9.8 cents per pound in 2008/09). The estimate of benefits resulting from government intervention in China received by producers in 2008/09 was about US$1.7 billion and $1.6 billion in 2009/10.

The government of China began providing an annual subsidy for using high-quality planting seeds in 2007 to growers in major growing areas in the amount of 500 million RMB, the equivalent of about $73 million. In 2009/10, the subsidy was expanded to cover all planting areas and is estimated at $180 million.

In addition, China provided subsidies for transportation of cotton from Xinjiang to mills in east and south China during the past two seasons in the amount of 400 RMB per ton ($59). It is estimated that the subsidy totaled about $150 in both 2008/09 and 2009/10.

All three types of subsidies totaled an estimated $1.95 billion in 2008/09 and $1.96 billion in 2009/10.

## India

The government of India significantly increased seed cotton minimum support prices (MSPs) at the start of 2008/09. As a result, government agencies purchased around 2.15 million tons of cotton lint, or a little over 40% of the estimated 2008/09 production.

The impact of government intervention as a result of the MSP increases resulted in the increase of cotton farm revenues in India by about US$331 million during 2008/09, or 3 US cents per pound of production. The Secretariat used the average difference between spot prices of H-4 seed cotton and the Cotlook A Index calculated between October 2008 and July 2009, adjusted for transportation costs, as an estimate of the support to Indian cotton prices that resulted from government intervention. During 2009/10, market prices stayed above the MSPs, resulting in no benefit for producers.

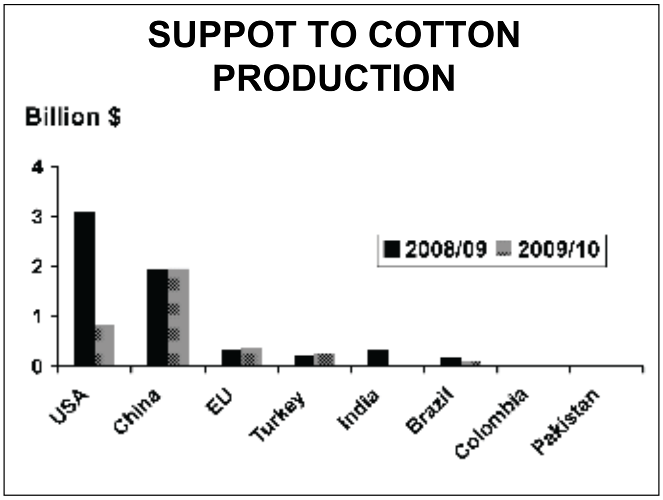
The Indian government also provided a 5% export incentive for cotton (estimated total $26 million) during 2008/09 that was not renewed in 2009/10. In addition, cotton farmers benefit from debt forgiveness and fertilizer subsidies from the government of India. These benefits are difficult to quantify, and they are not specific to cotton.

In April 2010, the Indian government announced the suspension of cotton export registrations and requested that cotton exports already registered, but not yet shipped, be revalidated, with a monthly cap on revalidations to be determined. This decision was taken in order to ensure a “reasonable carryover stock in the country” at the end of 2009/10. India is the second largest cotton exporter.

At the end of May 2010 the Indian government allowed cotton exports under license. It is now mandatory for exporters to receive licenses. Cotton exports will be subject to a flat rate duty of 2,500 rupees per ton (2.4 cents per pound) on all varieties.

## European Union

Changes were introduced in the EU Common Agricultural Policy (CAP) for 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 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 state 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 for Greece and at 3.5 tons for Spain. The fixed 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 2009/10 the amount of direct subsidy to production in Greece was $260 million ($271 million in 2008/09) resulting in 55 US cents per pound lint production (51 U.S. cents in 2008/09). The subsidy in Spain is estimated at $93 million ($90 million in 2008/09), or 196 US cents per pound of lint (241 U.S. cents in 2008/09).

## 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 2009/10 were increased to 0.42TRL/kg for seed cotton produced from certified seeds (28 US cents per kg) and 0.32TRL/kg for seed cotton produced from regular seeds (21 US cents per kg). The premiums were at 0.32TRL/kg (21 US cents per kg) and 0.27TRL/kg (18 US cents per kg) respectively in 2008/09. Assuming that 90% of Turkish cotton production is 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 to $260 million in 2009/10, up from $227 million paid in 2008/09.

## Brazil

Brazil continues 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 is used 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 76 cents per pound at the exchange rate prevailing as of mid-August 2010. The actual size of the premium is determined at auctions organized by the government. In 2008/09, payments under the PEPRO were $191 million (7 cents per pound), and declined to $99 million during 2009/10 (4 cents per pound).

## Colombia

In Colombia, direct government payments to producers in 2009/10 are estimated at $22 million, averaging 37 cents per pound. In 2008/09 direct government payments were estimated at $25 million averaging 31 cent per pound.

## Support Provided Through Input Subsidies and Deficit Reimbursement

Lower market prices during 2008/09 reduced the incomes of producers in a number of countries, especially in West and Central Africa, where the exchange rate remained unfavorable to producers and exacerbated the effects of low dollar prices.

The government of Cameroon subsidized fertilizers for cotton farmers and allocated $15 million to SODECOTON for this purpose in 2009/10.

The government of Mali subsidized 30% of fertilizer costs for 2009/10.

Burkina Faso provided producers with a fertilizer subsidy of 6.5 billion CFA ($14 million) in 2008/09 and 7.2 billion CFA ($15.5 million) for 2009/10. In addition, 4.4 billion CFA ($9.5 million) was provided to settle internal debts of farmer producer associations.

Benin provided an input subsidy of $24 million for 2009/10, and an additional $18.5 million is being given for three years to implement best crop management practices.

Côte d'Ivoire provided 18 billion CFA ($39 million) in subsidies during the past several years to maintain grower prices.

In Argentina, $20 million were provided to farmers during 2008/09 as support for pre-planting activities.

Price supports were also provided in 2008/09 by Tanzania and Uganda.

## 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.

Ten lists of registered companies have been published by AQSIQ. As of mid-August 2010, 250 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 | 2008/09 | | | 2009/10 ** | | |
|---|---|---|---|---|---|---|
| | 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 |
| China | 8,025 | 10 | 1,949 | 6,850 | 11 | 1,963 |
| USA | 2,790 | 50 | 3,092 | 2,654 | 14 | 818 |
| Greece | 240 | 51 | 271 | 215 | 55 | 260 |
| Turkey | 440 | 23 | 227 | 380 | 31 | 260 |
| Brazil | 1,214 | 7 | 191 | 1,171 | 4 | 99 |
| Spain | 17 | 241 | 90 | 22 | 196 | 93 |
| Colombia | 36 | 31 | 25 | 27 | 37 | 22 |
| India | 4,930 | 3 | 331 | 5,100 | 0 | 0 |
| Pakistan | 1,891 | 0.2 | 8 | 2,019 | | 0 |
| All Countries | 19,583 | 14 | 6,184 | 11,318 | 13 | 3,516 |

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

## Level of Direct Assistance Provided by Governments to the Cotton Sector Through Export Programs

| Country | 2008/09 | | | 2009/10 ** | | |
|---|---|---|---|---|---|---|
| | Exports | Average Assistance per Pound Exported | Assistance to Exports | Exports | Average Assistance per Pound Exported | Assistance to Exports |
| | 1,000 tons | US cents | US$ millions | 1,000 tons | US cents | US$ millions |
| USA | 2,890 | 0 | 10 | 2,613 | 1 | 30 |
| Upland cotton | 2,840 | 0 | 0 | 2,464 | 0 | 0 |
| Pima | 51 | 9 | 10 | 149 | 9 | 30 |
| India | 515 | 2 | 26 | 1,390 | 0 | 0 |
| Total | 566 | 3 | 36 | 149 | 9 | 30 |

** Preliminary.