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PRODUCTION AND TRADE POLICIES AFFECTING THE COTTON INDUSTRY

September 2013

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A report by the
Secretariat of the
International Cotton Advisory Committee



Washington DC, USA

GOVERNMENT SUPPORT TO THE COTTON INDUSTRY

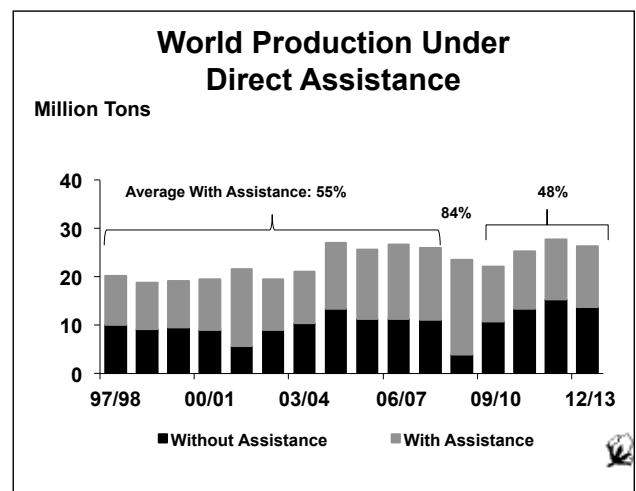
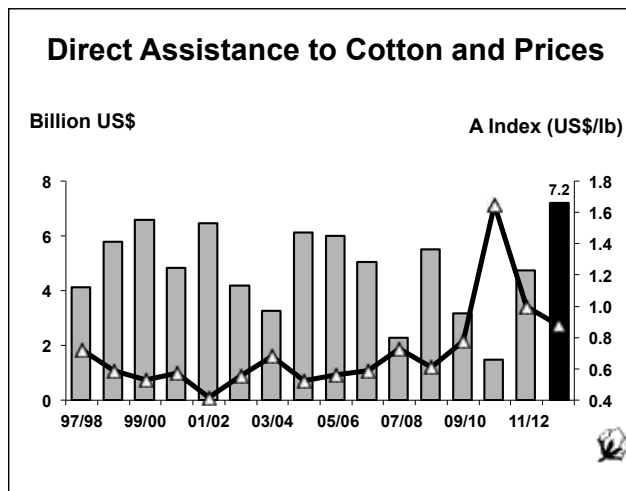
Subsidies to the cotton industry, including direct support to production, border protection, crop insurance subsidies, and minimum support price mechanisms are estimated at a record \$7.2 billion in 2012/13 up from \$4.7 billion in 2011/12. Ten countries provided subsidies in 2012/13, and the subsidies averaged 26 cents per pound, up from 17 cents per pound on average in 2011/12.

Since 1997/98 when the Secretariat first began reporting on government measures in cotton, there has been a strong negative correlation between subsidies and cotton prices: in years when prices are high, subsidies tend to decline and in years when prices are low, subsidies tend to rise. That relationship continued during 2012/13. The Cotlook A Index fell from an average of \$1 per pound to an estimated \$0.88 per pound, and subsidies provided to cotton growers rose substantially. It is notable that subsidies are rising during 2012/13 even though cotton prices are still well above the average of the last four decades of approximately 70 cents per pound.

In some countries, such as Pakistan or Mexico, minimum support price programs were not triggered during 2012/13 because market prices were above the government intervention prices.

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 2012/13, the share declined and averaged 48%.

Some countries provided subsidies for cotton inputs in 2012/13, especially for fertilizers, storage, transportation, classing services and other marketing costs.



China

The Government of China supports cotton production by controlling cotton import volumes and values and by applying border protection measures based on quotas and sliding scale duties, with an effective tariff of 40% on cotton imported without a quota. In addition, China maintains a strategic reserve of cotton, serving as a national buffer stock. The China National Cotton Reserve Corporation (CNCRC) is the agency that manages the state reserve. China releases cotton to the market from the reserve through a system of auctions when there is a shortage, and the government replenishes the reserve when there is abundance, thus supporting prices.

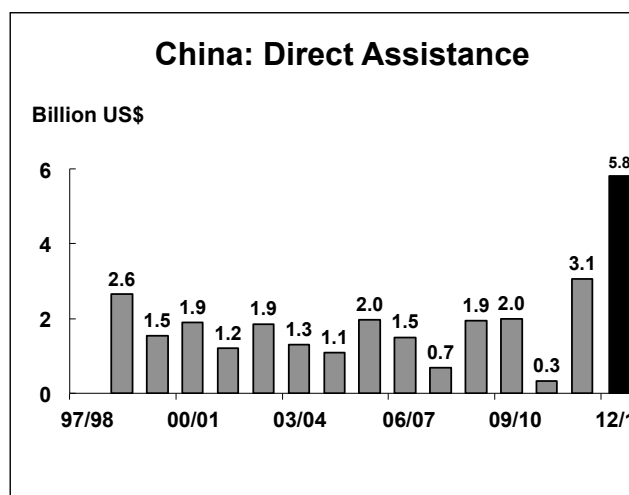
In 2011/12 and 2012/13, China implemented a system of minimum support prices by directly purchasing cotton from producers and rebuilding the government strategic reserve. The state reserve procurement price for 2011/12 was set at 19,800 yuan per ton for Type 328 (141 US cents per pound at the end of July 2012). China purchased 3.1 million tons of domestic cotton and about one million tons of imported cotton during 2011/12 for the state reserve. This resulted in a significant increase in world imports in 2011/12 and supported domestic and international prices.

China imported a record 5.3 million tons in 2011/12.

For 2012/13, the government procurement price was increased to 20,400 yuan per ton (147 US cents per pound at the seasonal average exchange rate) and between September 2012 and March 2013, China purchased 6.5 million tons of the 2012/13 crop for the reserve. These purchases by the Chinese government provided support to domestic and international prices and helped to keep world trade in record territory of 9.7 million tons, with Chinese imports accounting for 3.9 million tons. This policy also ensures that mill use and market share of cotton in China will continue to suffer. For 2013/14, the minimum support price remains unchanged at 20,400 yuan per ton (150 cents per pound as of mid-July 2013) and more government purchases are projected.

In 2012/13, China started to auction cotton from the reserve to mills. Between September 2012 and July 2013, China auctioned 3.3 million tons at an average price close to 135 cents per pound. This release from the reserve was aimed at easing the supply situation and reducing the government burden. Release of the reserves to domestic mills reduces the need for imports and limits growth in world trade. It is estimated, that the national reserve in China currently holds about 8.5 million tons. It is likely that China will continue auctioning reserve cotton regularly over the coming year.

It is estimated that the net cost of acquisition of cotton into the reserve during the two seasons was \$24 billion, while handling and warehousing of this cotton could cost \$2 billion a year.



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. As a result of government interventions and quotas, domestic cotton prices in China were above international 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 is used in calculations. The benefit (subsidy) received by producers in China as a result of the government interventions is estimated at \$2.7 billion in 2011/12, or 17 cents per pound and at \$5.5 billion in 2012/13, or 35 cents per pound.

In addition, the government of China pays growers a subsidy for using high-quality planting seeds, about \$150 million a year, however smallholder farmers do not significantly benefit from it. 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, and \$5.8 billion in 2012/13.

United States

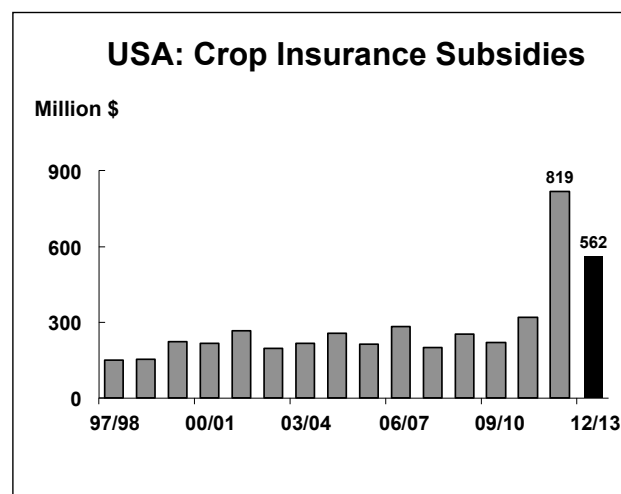
Because the 2013 farm bill in the U.S. has not been finalized, provisions of the existing legislation (Farm Bill 2008) were extended for 2013/14. During 2011/12 and 2012/13, the only subsidy received by producers under the U.S. cotton program was for crop insurance. All other subsidies were not available 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), marketing loan gain (MLG), and crop insurance. The CCP and

LDP/MLG were unavailable during the last two seasons.

U.S. cotton producers received about \$580 million in direct payments (DP) during 2012/13. 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 by the ICAC Secretariat.

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 15 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 \$226 million per year between 1997 and 2010. In 2011/12, total cotton crop insurance subsidies reached \$819 million, or 11 cents per pound of total production. The increase was caused by higher insurance premiums tied to the increased value of the crop because of higher market prices. In 2012/13, cotton insurance subsidies declined to an estimated \$562 million, or 7 cents per pound.

During 2011/12 and 2012/13, no payments under the U.S. Pima competitiveness program were made because prices for competing foreign growths remained relatively high.

India

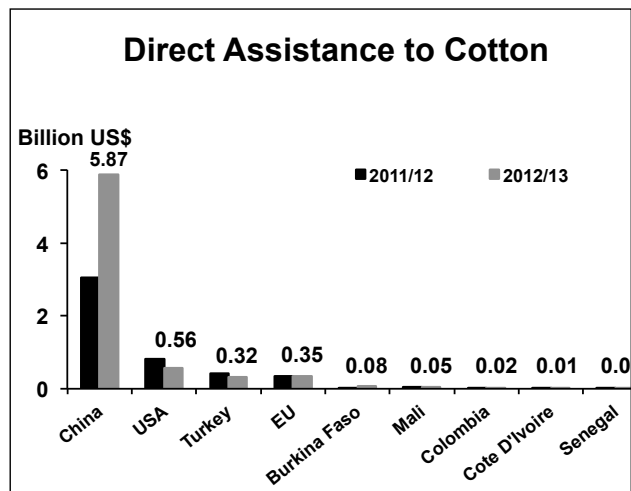
India has a system of Minimum Support Price (MSP), but because market prices were above the MSP during 2010/11 and 2011/12, there were no direct cotton purchases by the government and no payments to producers during these two seasons. In 2012/13, the MSP for medium staple cotton (J-34) was increased by 29% to Rs. 3,600 per 100 kg of seed cotton (up from Rs. 2,800), an equivalent of 87 cents per pound of lint at the season average exchange rate. The average domestic price for the same variety during the period was 79 cents per pound. Domestic prices were rising during 2012/13 and reached 83 cents per pound during July 2013. As a result, the government-owned Cotton Corporation of India purchased 425,000 tons of cotton, building a strategic reserve. The purchase expense for the government is estimated at about \$910 million dollars and if warehousing and handling costs are included, the total cost to the government could be about \$1 billion. It is expected that the government will be auctioning these stocks to mills, as domestic prices climb above the purchase cost.

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 are 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 2012/13 the amount of direct subsidy to production in Greece was \$262 million (\$266 million in 2011/12) resulting in 47 US cents per pound of lint production (43 U.S. cents in 2011/12). The subsidy in Spain is estimated at \$87 million (\$89 million in 2011/12), or 70 US cents per pound of lint (67 U.S. cents in 2011/12).



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 2012/13 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 produced from certified seeds, and that all cotton producers applied for the premium, the Secretariat estimates that total payments to cotton producers in Turkey declined from \$428 million in 2011/12, to \$312 million paid in 2012/13 as a result of reduced 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 60 cents per pound at the exchange rate prevailing at the middle of July 2013. 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 3 seasons market prices were above the minimum-guaranteed price.

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 a 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 the form of subsidized interest averaged \$75 million during the past decade.

Colombia

In Colombia, direct government payments to producers in 2012/13 are estimated at \$22 million, averaging 44 cents per pound. In 2011/12, direct government payments were estimated at \$29 million averaging 32 cent per pound.

West Africa

Several countries in West Africa provided subsidies for cotton inputs in 2011/12 and 2012/13, especially for fertilizers, and planting seeds. In 2012/13, Burkina Faso provided \$80 million (14 cents per pound); Mali provided \$50 million (11 cents per pound); Cote D'Ivoire \$14 million (5 cents per pound); and Senegal \$6 million (3 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-seven lists of registered companies have been published by AQSIQ. As of the beginning of July 2013, 759 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	2011/12			2012/13 **		
	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	7,400	19	3,053	7,300	36	5,813
USA	3,391	11	819	3,770	7	562
Turkey	750	26	428	550	26	312
Greece	280	43	266	251	47	262
Spain	60	67	89	57	70	87
Burkina Faso	174	2.6	10	260	14	80
Mali	187	9	38	189	12	50
Colombia	41	32	29	21	49	22
Cote D'Ivoire	113	6	14	140	5	14
Senegal	50	3	4	63	4	6
All Countries	12,445	17	4,749	12,601	26	7,209

* 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 ***

	World 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	23,503	11	5,492
2009/10	22,247	6	3,155
2010/11	25,368	3	1,477
2011/12	27,793	8	4,749
2012/13**	26,386	12	7,209

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

** Preliminary.