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PRODUCTION AND TRADE POLICIES AFFECTING THE COTTON INDUSTRY

October 2017

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A report by the
Secretariat of the
International Cotton Advisory Committee



Washington DC, USA

GOVERNMENT SUPPORT TO THE COTTON SECTOR

Subsidies to the cotton sector, including direct support to production, border protection, crop insurance subsidies, and minimum support price mechanisms, have been estimated at \$4.5 billion in 2016/17, which is down 39% from \$7.4 billion in 2015/16. Ten countries provided subsidies in 2016/17, and the subsidies averaged 11 cents/pound, down from 18 cents/pound in 2015/16.

Since 1997/98, when the Secretariat 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. This relationship has been maintained during the past several seasons. The Cotlook A Index declined from an average of 91 cents/pound in 2013/14 to an average close to 70 cents/pound in 2014/15 and 2015/16 and then rose to 83 cents/pound in 2016/17. Subsidies provided to cotton growers declined in 2016/17 from record levels.

In some countries, including Brazil, Pakistan and India, minimum support price programs were not triggered, or were only partially active during 2016/17 because market prices were above the government intervention price levels during most of the season. A number of countries implement border protection measures during some seasons, and the Secretariat makes every effort to report on the effect of these measures when they are quantifiable.

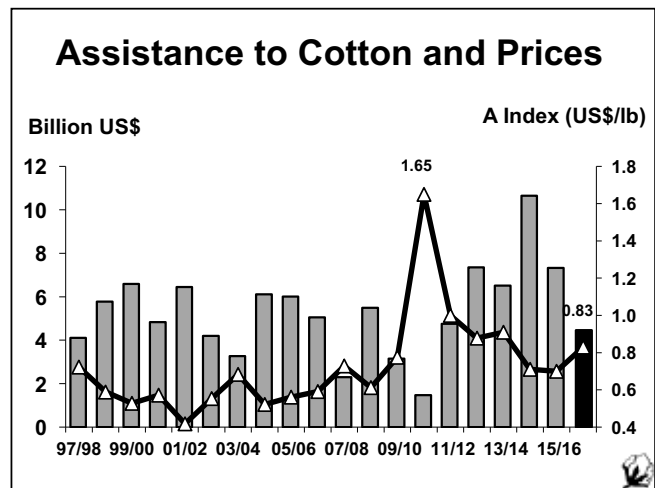
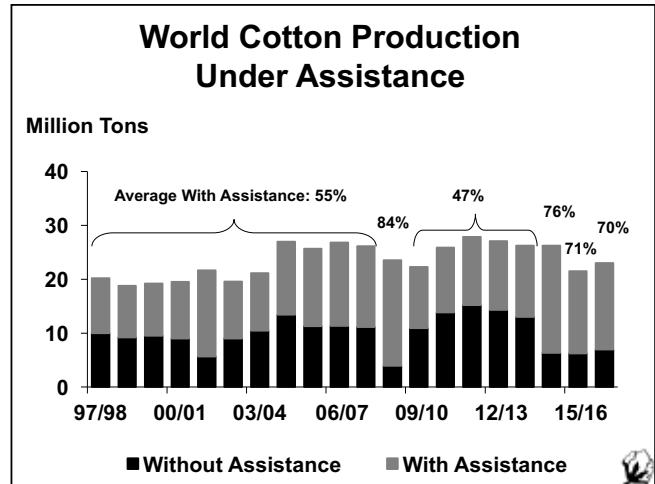
Some countries continued to provide subsidies for cotton inputs in 2016/17, especially for fertilizers, storage, transportation, classing services and other marketing costs. At the same time, the use of crop insurance subsidies is increasing, although still not widespread.

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 83% in 2008/09. During 2009/10 through 2013/14, this share declined and averaged 48%. In 2014/15 the proportion of production receiving direct assistance increased to 76%. The share declined to 71% in 2015/16 and to 70% in 2016/17.

China

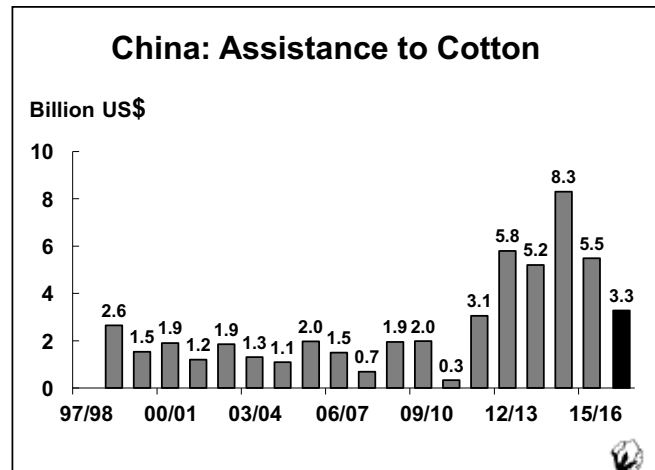
The Government of China supports cotton production by controlling cotton import volumes and values and by applying border protection measures based on quotas and sliding scale duties, with an effective tariff of 40% on cotton imported without a quota. In addition, China maintains a strategic reserve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

During the past three seasons there were no purchases by the government. Instead, the government paid direct subsidies to cotton growers, in addition to the border protection benefits enjoyed by producers in China.



Under the terms of its accession agreement to 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. During 2015/16 and 2016/17, China restricted imports by issuing only the TRQ import quotas, with the objective of reducing government stocks. As a result of government interventions and quotas, domestic cotton prices in China have exceeded international prices during these two seasons.

The Secretariat uses the difference between domestic and imported cotton prices to estimate the border protection support to Chinese cotton resulting 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 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 border protection, is estimated at \$980 million in 2016/17, or 9 cents/pound, down from \$1.1 billion, or 10 cents/pound, in 2015/16.



In addition, during 2015/16 and 2016/17 the Chinese government provided direct subsidy payments to cotton producers in Xinjiang based on the difference between a target price set for the season and an average market price. For 2015/16, the target price was set at 19,100 yuan/ton (about 134 cents/pound at the average seasonal exchange rate). The target price was reduced to 18,600 yuan/ton (about 124 cents/pound at the average seasonal exchange rate) for 2016/17. Using the difference between the target price and the average CC index (domestic cotton price), it is estimated that direct subsidies paid to producers in Xinjiang totaled \$1.6 billion, or 20 cents/pound in 2016/17, down from \$3.5 billion, or 45 cents/pound in 2015/16. In other provinces a direct subsidy of 2,000 yuan/ton was provided to producers during both seasons. It is estimated that these direct subsidies totaled \$380 million, or 13 cents/pound in 2016/17, down from \$530 million or 14 cents/pound in 2015/16. Total direct subsidy payments provided to producers in China in addition to border protection support are estimated at \$2 billion in 2016/17, down from \$4 billion in 2015/16. The decline is attributed to a reduction in the difference between the target and the market price during 2016/17.

In addition, the government of China pays growers a subsidy for using high-quality planting seeds, amounting to about \$150 million a year, although smallholder farmers do not benefit significantly from this policy. During the past several seasons, China provided subsidies for transportation of cotton from Xinjiang to mills in eastern and southern China, which are estimated at about \$150 million per year.

The sum of all subsidies provided by the Chinese government are estimated at \$3.3 billion in 2016/17, or 30 cents/pound, down from \$5.5 billion in 2015/16 (48 cents/pound).

United States

The 2014 five-year farm bill marks an evolution from traditional farm income support programs to a focus on production and price risk management, with government-subsidized crop insurance as the primary instrument. Direct Payments, Countercyclical Payments and Average Crop Revenue Election (ACRE) programs have been repealed for all commodities. Upland cotton is not eligible for other commodity risk management programs established under the bill, but cotton producers are eligible for a new and unique “safety net” program, the Stacked Income Protection Plan (STAX).

STAX provides upland cotton producers with premium subsidies on the purchase of insurance policies that cover “shallow” revenue losses--those below the level generally covered by standard crop insurance policies. Producers may use this program alone or in combination with existing underlying crop insurance. Under STAX, a payment is triggered if

the actual income in a county (A county is a unit of government in the United States; there are about 700 counties that produce cotton.) falls below 90% of the expected income. STAX provides coverage for revenue shortfalls between 10 and 30% of expected income and producers may select coverage in 5% increments. The federal government subsidizes about 80% of the premium. In addition, the federal government partially subsidizes the administrative and operational costs of the insurance companies offering STAX.

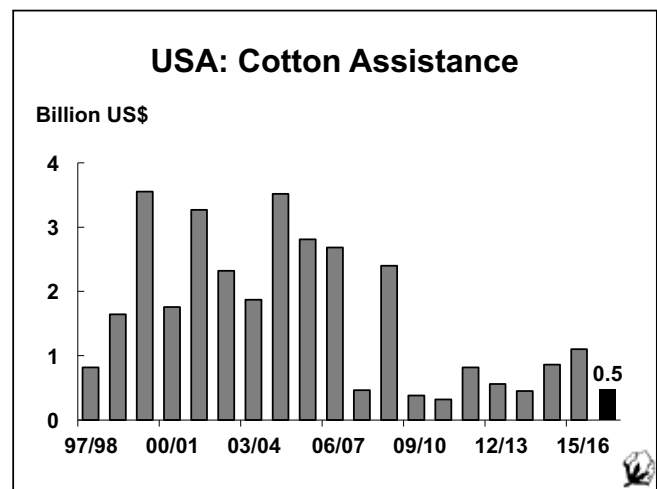
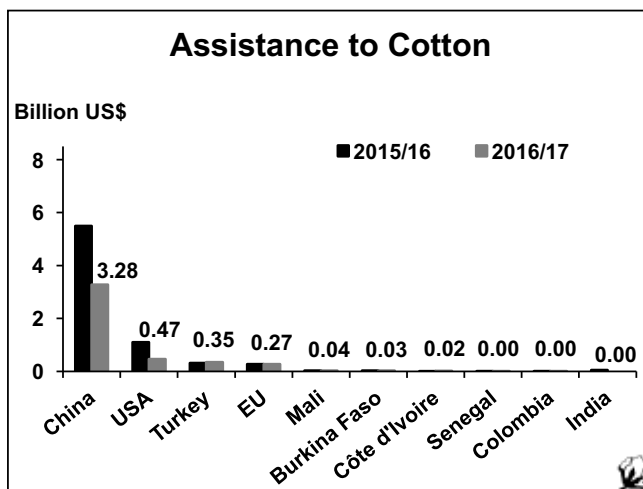
STAX came into effect during the 2015 growing season (starting in August 2015). Total subsidies provided under STAX in 2015/16 are estimated at \$76 million. With about 1.023 million hectares, or about 32% of harvested area in 2015/16. In 2016/17, STAX subsidies are estimated at \$74 million with about 1.036 million hectares enrolled, or 27% of the harvested area. A significant share of STAX policies were purchased in combination with an underlying standard crop insurance policy.

The Marketing Loan Program (MLP) continues with a marketing loan rate based on the world cotton price, calculated as the simple average of the adjusted prevailing world price (AWP) for the two immediately preceding marketing years (announced October 1 preceding the next domestic plantings), but it cannot be lower than 45 cents/pound or higher than 52 cents/pound. The loan rate for extra-long staple (ELS) cotton is set at 79.77 cents/pound. Under this program, upland cotton producers are eligible for a loan deficiency payment (LDP), certificate exchange gains or marketing loan gains (MLG). The LDP is paid when market prices (AWP) are below the loan rate. Commodity certificate exchange gains and marketing loan gains provide the same gains as the LDP by redeeming a loan at a reduced rate. Only one of these options is available to upland cotton producers. ELS cotton producers must repay the loan at the loan rate plus interest or may forfeit the ELS cotton used as collateral if market conditions warrant. Based on average market prices, it is estimated that there were no LDPs and MLGs during 2016/17. In 2015/16 the LDPs were estimated at \$139 million and MLGs at \$188 million.

In addition, 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. This multi-peril crop insurance covers nearly every cause of declines in crop yields, such as weather, pests, and fire, with the exception of producer negligence. The insurance is largely sold to farmers through private insurance providers, although the Risk Management Agency (RMA) of the U.S. Department of Agriculture pays more than half of the premiums. On average, more than 90% of planted cotton acreage is enrolled in this program.

The crop insurance program is statutorily mandated to be actuarially sound, meaning that total premiums are supposed to cover total indemnities over time. Underwriting gains and losses are allocated between the companies and government according to formulas contained in the reinsurance agreement between the parties. During 2016/17, cotton insurance subsidies are estimated at \$457 million, or 5.7 cents/pound, compared with \$460 million, or 7.7 cents/pound in 2015/16.

In addition to described support, the USDA announced on June 6, 2015, that the USDA Farm Service Agency (FSA)



will provide an authorized maximum of \$300 million in cost-share assistance payments to cotton producers through the new Cotton Ginning Cost-Share program in order to expand and maintain the domestic marketing of cotton. Through this program, eligible producers could receive a one-time cost-share payment, which was based on producers' 2015 acres reported to FSA, multiplied by 40% of the average ginning cost for each production region. Enrollment for this program ran from June 20, 2016 through August 5, 2016, and payments began in July 2016. Eligibility requirements include \$40,000 per producer payment limit, requirement to be actively engaged in farming, compliance with conservation standards and a \$900,000 adjusted gross income limit.

The sum of all types of support provided to U.S. cotton producers, including crop insurance, STAX, LDP, MLG and the Cotton Ginning Cost-Share program, is estimated at \$1.2 billion, or 19 cents/pound in 2015/16. During 2016/17 total support to U.S. cotton producers declined to an estimated \$531 million or 6 cents/pound.

India

India has a Minimum Support Price (MSP) system which was operational during 2014/15 and 2015/16 through direct cotton purchases by the government because market prices were below the MSP during at least part of those seasons.

The MSP for 2015/16 was increased to Rs4,000 per 100kg of seed cotton, equivalent to 80 cents/pound of lint, at the season average exchange rate. Domestic prices in India stayed below the MSP for a short period during the first half of the season and were estimated at 64 cents/pound. As a result, the CCI procured 144,000 tons at MSP prices at an estimated cost of \$250 million. Based on the difference between the procurement price and the value of the government stock at market prices, it is estimated that the cost of MSP operations to the Indian government was \$51 million, or 0.4 cents/pound of lint production. The MSP for 2016/17 was set at Rs4,060 per 100kg of seed cotton, equivalent to 82 cents/pound of lint, at the season average exchange rate. There were no MSP operations in India in 2016/17.

Cotton farmers in India benefit from debt forgiveness and fertilizer subsidies from their government. India also provides some backing in the form of subsidies for crop insurance, although the value of this support is unknown. In addition, the Government of India provides support to cotton production through several programs, such as the development of infrastructure facilities for production and distribution of quality seeds. Under the government's Technology Mission, support was provided for the modernization of ginning and pressing units and the improvement of cotton marketing in recent years. No information on these programs is publically available. 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 starting in 2009/10. As before, cotton producers receive 65% of EU support in the form of a single decoupled payment (income aid) and the remaining 35% in the form of 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 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/hectare for Greece and at 3.5 tons/hectare for Spain. The amounts per hectare are fixed at 234.18 euros for Greece and 362.15 euros for Spain. If the eligible area exceeds the maximum base area, the aid per hectare is reduced proportionally.

In 2016/17 the amount of direct subsidy to production in Greece was estimated at \$204 million (\$208 million in 2015/16), equivalent to 43 cents/pound of lint production (same in 2015/16). The subsidy in Spain is estimated at \$66 million in 2016/17 (\$68 million in 2015/16), or 55 cents/pound of lint (53 cents/pound in 2015/16). The decline is mostly a result of a stronger U.S. dollar in relation to the euro.

Turkey

The government of Turkey pays a premium per kilogram of seed cotton to producers. In the past the premium for seed cotton produced from certified seeds was higher than that from non-certified seeds. No premium has been paid for non-certified seed since 2012/13. The premium for 2016/17 was increased to 0.75 TRL/kg, from 0.65 TRL/kg in 2015/16, for seed cotton produced from certified seeds. 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 increased from \$320 million in 2015/16 equivalent to 23 cents/pound of lint production, to \$351 million in 2016/17 (23 cents/pound).

Colombia

In Colombia, direct government payments to producers declined during the past several seasons. In 2015/16, direct assistance to cotton producers in Colombia was estimated at \$3 million, averaging 10 cents/pound. In 2016/17, direct government payments declined further to just \$1 million, averaging 7 cents/pound. Actual payments in Colombian pesos declined by 63% during 2016/17, but payments in U.S. dollar equivalent declined by 61% due to the depreciation of the domestic currency.

West Africa

Several countries in West Africa provided subsidies for cotton inputs in 2016/17 and 2015/16, especially for fertilizers and planting seeds. In 2016/17, Mali provided an estimated \$35 million (6 cents/pound); Burkina Faso \$32 million (5 cents/pound); Côte d'Ivoire \$15 million (5 cents/pound); and Senegal \$2 million (13 cents/pound).

**Estimated Assistance Provided by Governments to
the Cotton Sector***

Country	2015/16			2016/17 **		
	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	5,200	48	5,491	4,900	30	3,279
USA	2,806	19	1,163	3,738	6	531
Turkey	640	23	320	703	23	351
Greece	218	43	208	213	43	204
Spain	58	53	68	55	55	66
Mali	216	7	32	265	6	35
Burkina Faso	244	6	30	285	5	32
Cote D'Ivoire	134	5	14	140	5	15
Senegal	7	12	2	7	13	2
Colombia	13	10	3	8	7	1
India	5,746	0.4	51	5,775	0	0
All Countries	15,282	18	7,382	16,090	11	4,515

* Credit assistance not included. ** Preliminary.

**Estimated Assistance Provided by Governments to
the Cotton Sector***

	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	19,527	11	4,833
2001/02	21,668	13	6,446
2002/03	19,580	12	4,193
2003/04	21,129	7	3,270
2004/05	26,989	10	6,114
2005/06	25,679	11	6,008
2006/07	26,832	9	5,045
2007/08	26,163	4	2,292
2008/09	23,551	11	5,492
2009/10	22,310	6	3,155
2010/11	25,667	3	1,477
2011/12	27,837	8	4,866
2012/13	26,774	12	7,351
2013/14	26,170	11	6,513
2014/15	26,235	18	10,653
2015/16	21,303	16	7,382
2016/17**	23,065	9	4,515

* Credit assistance not included. ** Preliminary.