REPORT FROM BRAZIL

ON

INJURY FROM LOW COTTON PRICES

ICAC
WORKING GROUP ON GOVERNMENT MEASURES
WASHINGTON D.C.
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Summary:

Brazilian production has recently rebounded from record low levels, as a result of large private investments in high-tech production in a new production frontier, with ideal soil, topography and rain fall combination. These investments, in turn, were attracted by Brazilian growing consumption, which had not been met by domestic production since 1991. As a result, after 10 years of lagging behind, production met domestic consumption once again in 2001. But, as a result of low prices, area planted in 2002 fell by 13.6% and, consequently, production is estimated to fall by 16%.

The injury caused by low prices, measured as the sum of the individual impacts on income, trade balance, related services (transportation and ginning), federal and state revenues, employment and the federal budget, is in excess of $600 million, as shown in the following table:

Brazil: Injury from Low Cotton Prices	
Impacted Factor	$ Million
Income	138.8
Trade balance	100.0
Related services	17.7
Federal and state revenues	98.0
Employment	234.0
Federal budget	50.0
Total	638.5

I. Introduction:

Since the 1996/1997 crop, when Brazilian cotton production reached bottom at 300,000 tons, after falling from levels of 700,000 tons and above in a short period of four years, the national industry has gone through a major change, nothing short of a revolution.

While small farmers found it hard to stay in business under unfavorable economic conditions and no government support, others, with capital, saw an opportunity. Fueled by a domestic demand in excess of 800,000 tons and rising prices, farmers from Southeastern Brazil started moving into and/or investing in large properties in Brazil's new agricultural frontier: the Western-Central part of the country, where topography, climate and soil characteristics combine to offer ideal conditions for large scale, highly-mechanized farm operations. More recently, for the same reasons, similar initiatives have taken place in South-Western Bahia.

Investments were geared toward property infrastructure, commodity market instruments, technology, machinery and equipment. As it grew, the industry became more organized, with the creation of seven state associations, which, in turn, jointly formed a national association to coordinate and promote industry positions to the federal government and society as a whole. They have led efforts to increase awareness in all aspects of cotton production, including labor (establishing norms regarding social well being and health), technology (promoting improved seed quality and less fiber contamination), and the environment (teaching about adequate disposal of agrochemicals, preservation of marshlands and conscientious use of insecticides). The main purpose is to sustain a more efficient, lower-cost production and better-quality product, with less of an impact in the local environment.

The results have been impressive. Production in the State of Mato Grosso alone, the main production area in Central Brazil, reached over 500,000 tons of lint in 2000/2001, or 60% of Brazilian production. Productivity was a record 3,500kg of unginned cotton per hectare, which raised the national productivity to new levels, 2,834 kg/ha, a 25% increase over the previous season (Table 1). Brazilian production had not met domestic consumption since 1991, but finally, at the end of five long years of efforts by private individuals and corporations, that level was reached once again in 2001 (Chart 1).

However, price conditions in the world and domestic markets have been progressively weak (Chart 2). As the ICAC has noted, international cotton prices, as measured by the Cotlook A Index, collapsed from 66 cents per pound in December 2000 to 41 cents per pound in April 2002. This has negatively impacted the area planted for the Brazilian 2001/2002 crop, to the tune of 14%.

The Brazilian government and producers are concerned with the growing use of government subsidies to production and exports, especially in major exporting countries, because of their undue negative influence on international prices. The ICAC has pointed out that government subsidies to cotton producers have increased world production, despite all economic factors recommending against it, and greatly contributed to the decline of market prices, with an estimated impact of minus 31 cents per pound in 2001/2002, almost double the impact of the previous season (-17 cents per pound).

The perverse effects of major exporters' subsidies on prices, however, are not affecting all producers. A privileged minority, responding for almost 50% of world production and a major share of world exports, besides being a main cause of the problem, is being shielded from this price reduction by way of government aid. In addition, in the case of the two major world producers, exports are aided by government subsidies as well.

This is a blatantly unfair situation, which is hurting unsubsidized producers in Brazil, and elsewhere in the world, not only domestically, but abroad, in export markets. Unsubsidized producers are being forced to reduce production in the face

of lower prices and take financial losses to compensate for ill-advised increased production in subsidizing countries, bringing about additional adverse economic and social repercussions in their respective countries. This report addresses such injuries to the Brazilian economy.

II. Overview of the Cotton Sector:

Production in Brazil rose, as a result of the structural changes explained earlier, from a record low-level of 38% of domestic consumption in 1996/1997 to 109% of consumption in 200/2001, or 939,000 tons of lint. However, low prices are leading to a drop in production of 16% this season. Area planted in 2001/2002 was 750,000 hectares, 13.6% smaller than last season. The leading producing region is the Center-West, which accounts for 70% of Brazil's production and the country's highest productivity, with 3,442 kg of unginned cotton per hectare. The national average is 2,754 kg per hectare (Table 1).

The quality of Brazilian cotton in general has made quantum leaps in terms of grade, staple, strength and uniformity amongst other quality criteria, especially in the state of Mato Grosso (Center-West). New seed varieties are being constantly developed to improve productivity as well as quality (see representative classing results in Chart 3).

As a reviving industry, growers have opted to employ used ginning equipment in order to reduce initial capital outlay. Though the quality of ginning is generally good, the older gins do require more regular maintenance and skilled labor, and have a low production output. It is estimated that in the near future more modern gins, with greater capacity and flexibility, will be introduced in the larger growing regions.

Brazilian exports are expected to fall from 147,000 tons in 2001 to an estimated 86,000 tons in 2002, about 11% of production. Despite the improved quality of Brazilian cotton, which is finding acceptance in many world markets, weak market conditions and subsidy-induced, record exportable stocks in the United States are combining to reduce demand for Brazilian cotton abroad. Imports are increasing in 2002 to an estimated 133,000 tons, as a result of expected lower production levels, up from 81,000 tons in 2001 (Table 2).

The stable and growing economy has resulted in increased consumption of cotton in Brazil, after being stagnant for many years. The devaluation of the real in 1999 has encouraged a recovery of exports of textile products and the negative balance of textile trade has narrowed. Increased cotton exports have also assisted in achieving this surplus (Table 2).

Consumption of all fibers is expected to increase during the next decade along with population growth, together with a greater purchasing power that will raise the per capita consumption of fibers from 7.7 kg in 1999 to 10.5 kg in 2005 and 11.7 kg by

2008, still considerably less than consumption per capita in the developed nations where the average fiber consumption reaches 25 to 30 kg.

To meet this expected demand, fiber production will expand not only for cotton, but also for synthetic fibers. Cotton's challenge will be to maintain the high market share of 65% of all fibers in Brazil, which will require that domestic production continue growing.

As the central Brazilian Savannahs are situated between the Amazon basin to the north and the wetlands of the Pantanal in the south, preoccupation regarding ecologically friendly farming is foremost in the minds of producers and consumers, as well as the federal government. The development of new seeds resistant to the diseases prevalent in the new growing areas is an ongoing requirement to achieve a sound balance between productivity and preserving nature.

III. Quantifying Economic Injury from Low Prices:

The effects are examined and quantified with respect to income, trade balance, services from related industries, tax revenues, employment and federal budget. This should not be regarded as an examination of all injurious effects from low prices, but rather of the most significant ones.

a. Impact on Income:

Average prices in Brazil followed the trend of international prices, dropping from 51 cents p/LB in 2000 to 38 cents p/LB in 2001 (Chart 2). As a result, area planted fell by 14% in 2002, which caused an expected fall in production from 939,000 tons of lint in 2001 to 786,000 tons in 2002 (Table 2). The injury from lower prices, expressed as the decrease in production of lint (153,000 tons) times the 2001 average price for Brazil (38 cents p/LB = 88.77 cents p/kg), comes to $128 million.

There was a loss also on the production of cottonseed for animal feed and other uses, which fell from 1.52 million tons in 2001 to an estimated 1.28 million tons in 2002 (Table 1). This reduction of 240,000 tons, times the Brazilian average price of $40 per ton (R$93 per ton) for farm feed and $46 per ton (R$106 per ton) for other out-of-farm uses, produces an impact of $10.8 million, based on Mato Grosso's ratio of 3/22 for internal use (Table 3).

b. Impact on the Trade Balance:

Since production in 2002 is expected to fall below domestic consumption, export levels are expected to drop to 86,000 tons, from 147,000 tons in 2001 (Table 2). This reduction (61,000 tons) times the 2001 average price (88.77 cents p/kg) results in an injury of $54 million. Imports, for the same reasons, are expected to rise in 2002 to 133,000 tons, from 81,000 tons in 2001, which results in an increase of 52,000 tons, or $46 million (Table 2). The resulting impact on the cotton balance of trade is, therefore, $100 million.

c. Impact on Related Industries:

Transportation services from farm or distribution centers to port average $80.00 per ton. If there was a loss of exports of 61,000 tons, the lost revenue to that industry was $4.9 million.

Lower production levels also means less ginning activities. The average cost of ginning services in Brazil is 10% of production value. Since the value of lost production was $128 million, the revenue loss for ginners was $12.8 million.

d. Impact on Federal and State Revenues:

Federal and state taxes were also forgone on the amount not sold. According to the official data from the State of Mato Grosso (Table 3), the revenue from the local sales tax (ICMS) on cotton and seed cotton fell from R$150 million in 2001 to an estimated R$114 million in 2002. The shortage is of R$36 million or $15.5 million. Since Mato Grosso responds for 60% of Brazilian production, the total loss of ICMS revenues for all producing states combined can be roughly estimated at $26 million.

From cotton-related services, the State of Mato Grosso's revenues fell from R$411 million to an estimated R$312 million (Table 3), which resulted in a loss of $43 million (R$99 million). Using the same criterion to roughly estimate the national total, all producing states combined had a loss of $72 million.

e. Impact on Employment:

Based on official data of the State of Mato Grosso, employment in the cotton and related services industries fell from 157,000 to 118,000 (Table 3). This loss of 39,000 jobs, if extrapolated for the country as a whole on the basis of production, will certainly underestimate the national impact, since Mato Grosso, the most mechanized producing region, employs less workers per hectare planted than any other state in Brazil. Nevertheless, in the absence of exact data, that same criterion is used to extrapolate the loss of jobs in Mato Grosso to all producing regions combined, which comes to 65,000 jobs. Since the impact on employment happened in the course of one year, any unemployment caused by changes in technology is likely to be negligible or non-existent.

The country's average salary, according to the Brazilian Cotton Producers Association (ABRAPA), including cotton pickers, machinery operators, engineers and administrators, is $300 per month, which equates to an impact of $234 million from lost jobs.

f. Impact on the Federal Budget:

In order to reduce supply and weaken downward pressure on domestic prices, the Federal Government authorized emergency funds of $50 million for government purchases of up to 60,000 tons, which has been in effect since March 1st 2002. This is a one-time authorization designed to address present exceptional circumstances. No further support measures are being sought or considered at this stage.

g. Other Impacts:

In light of the record-level stocks of exportable, subsidized cotton in major producing countries, Brazilian producers have been forced to hire legal experts in order to exercise their right of defense against a potential flood of unfairly traded cotton from those countries. At the same time, experts on WTO dispute settlement were also hired in order to provide legal support to government actions against those subsidies at the multilateral level. Countless hours of government personnel are also being spent on preparation for the domestic and multilateral trade cases. Since these are on going actions and, in the case of the WTO, novel initiatives, a cost estimation was not attempted, but should be kept in mind, together with all the other injurious effects not considered here, in order to show that the total impact presented in this report, albeit considerable for a one year period, is still underestimated.

COTTON PRODUCTION AND DOMESTIC CONSUMPTION: BRAZIL

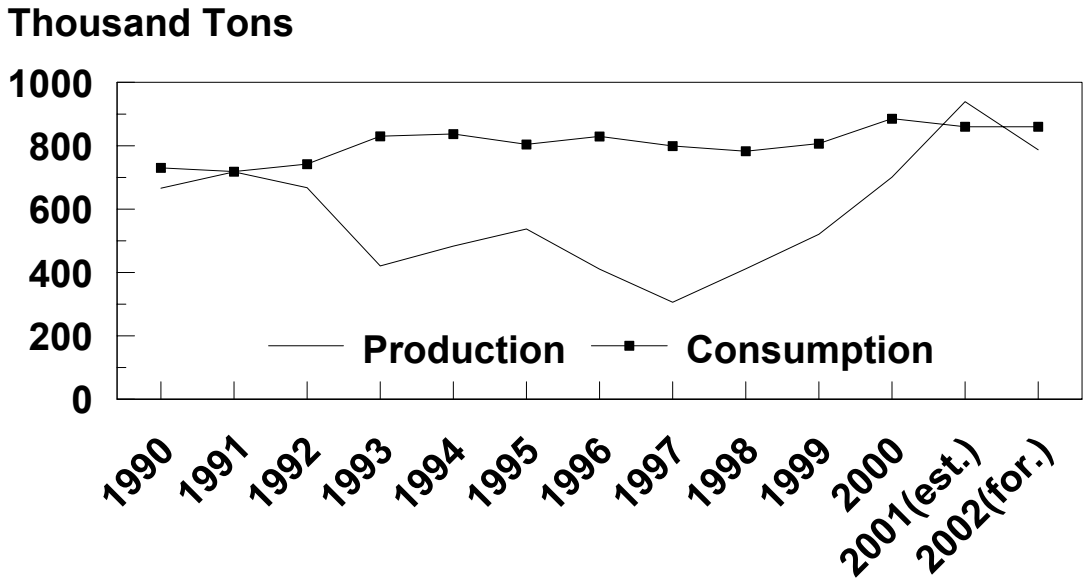


Chart 1

AVERAGE COTTON PRICES

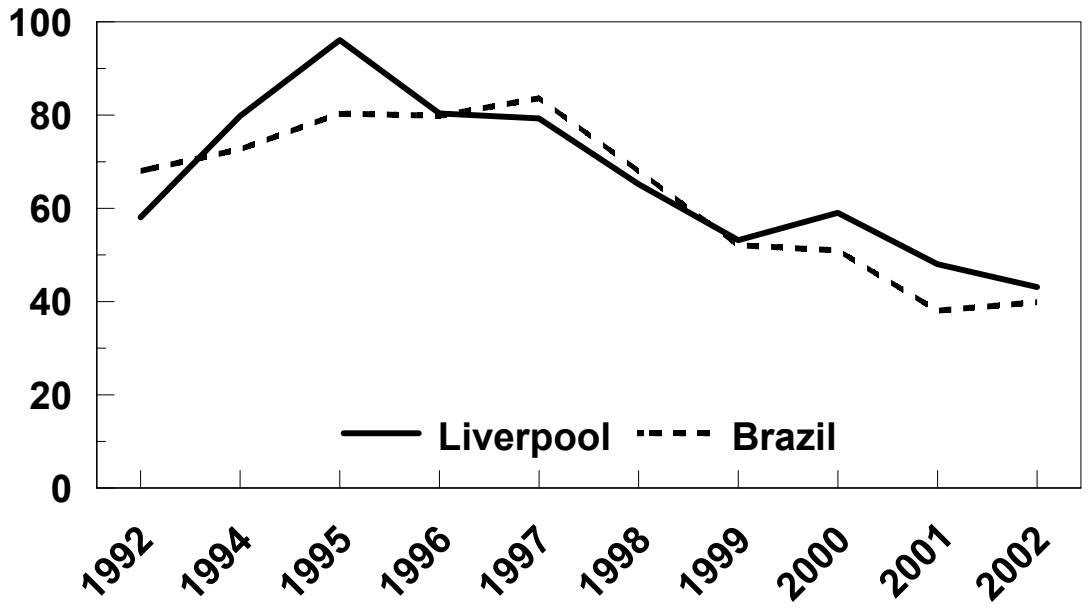
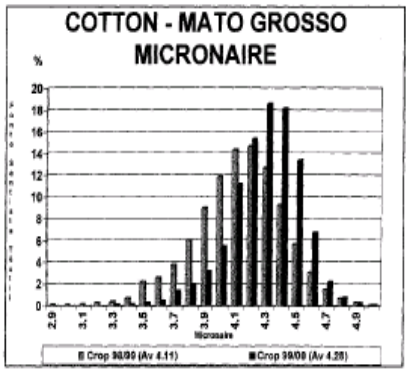
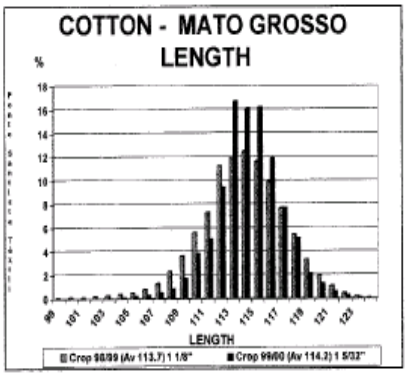
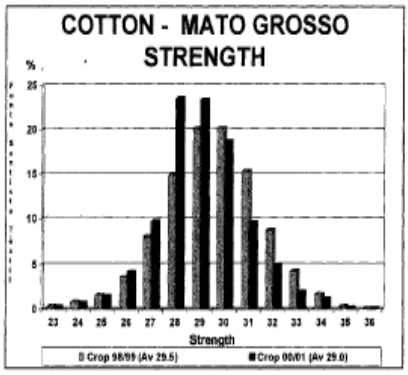


Chart 2

Quality Improvement







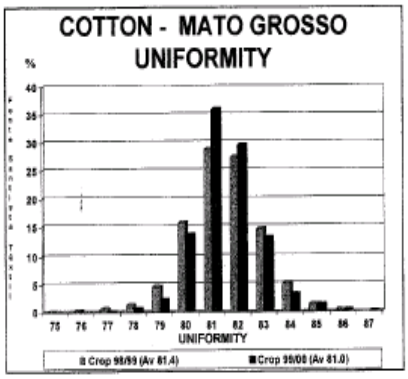


Chart 3

TABLE 1

BRAZIL: COTTON AREA, PRODUCTION AND YIELD (2000/2001 AND 2001/2002)

STATE / Region	AREA (1,000 ha)			PRODUCTION (1,000 TON)						YIELD* (kg/ha)		
				Cotton lint			Cottonseed					
	2000/01	01/02	VAR (%)	2000/01	01/02	VAR (%)	2000/01	01/02	VAR (%)	2000/01	01/02	VAR (%)
RO	2.6	-	-	1.2	-	-100.0	2.3	-	-100.0	1,355	-	-100.0
PA	-	-	-	-	-	-	-	-	-	-	-	-
North	2.6	-	-100.0	1.2	-	-	2.3	-	-	1,346	-	-
MA	2.4	3.1	29.0	2.9	4.0	-	5.0	6.7	-	3,300	3,450	-
PI	8.1	8.9	10.0	0.8	2.2	175.0	1.6	4.5	181.3	300	750	150.0
CE	29.4	40.0	36.0	4.0	9.2	130.0	8.1	18.8	132.1	410	700	70.7
RN	19.7	23.6	20.0	1.2	4.5	275.0	2.4	9.2	283.3	180	580	222.2
PB	8.4	12.2	45.0	1.0	3.0	200.0	2.0	6.1	205.0	350	750	114.3
PE	7.3	10.2	40.0	0.8	1.2	50.0	1.7	2.4	41.2	350	350	-
AL	21.0	21.0	-	4.2	4.2	-	8.4	8.4	-	600	600	-
SE	0.3	0.3	-	-	-	-	-	-	-	180	180	-
BA	55.0	69.1	25.6	61.4	78.3	27.5	98.1	125.2	27.6	2,900	2,945	1.6
Northeast	151.6	188.4	24.3	76.3	106.6	39.7	127.3	181.3	42.4	1,343	1,528	13.8
PR	68.4	39.0	-43.0	58.2	32.0	-45.0	104.9	57.7	-45.0	2,385	2,300	-3.6
Sul	68.4	39.0	-43.0	58.2	32.0	-45.0	104.9	57.7	-45.0	2,385	2,300	-3.6
MG	38.6	37.8	-2.0	29.4	29.4	-	50.1	50.0	-0.2	2,060	2,100	1.9
SP	65.7	61.1	-7.0	60.0	54.6	-9.0	104.3	95.1	-8.8	2,500	2,450	-2.0
Southeas	104.3	98.9	-5.2	89.4	84.0	-6.0	154.4	145.1	-6.0	2,337	2,316	-0.9
MT**	392.0	294.0	-25.0	533.9	407.2	-23.7	842.1	642.3	-23.7	3,510	3,570	1.7
MS	50.4	45.4	-10.0	66.5	59.9	-9.9	106.2	95.6	-10.0	3,425	3,425	-
GO	97.6	83.1	-14.9	111.3	94.7	-14.9	181.5	154.6	-14.8	3,000	3,000	-
DF	1.5	1.6	6.7	2.0	2.1	-	3.2	3.4	-	3,450	3,450	-
C-West	541.5	424.1	-21.7	713.7	563.9	-21.0	1,133.0	895.9	-20.9	3,410	3,442	0.9
N/NE	154.2	188.4	22.2	77.5	106.6	37.5	129.6	181.3	39.9	1,343	1,528	13.8
C-South	714.2	562.0	-21.3	861.3	679.9	-21.1	1,392.3	1,098.7	-21.1	3,155	3,165	0.3
Brazil	868.4	750.4	-13.6	938.8	786.5	-16.2	1,521.9	1,280.0	-15.9	2,834	2,754	-2.8

SOURCE: CONAB **Feb-02**

(*): Yield expressed in unginned cotton.

BRAZIL: COTTON LINT SUPPLY AND DEMAND (1990 - 2002)
(1,000 TONS)

FEBRUARY/02

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001 (1)	2002 (2)
S U P P L Y	**877.0**	**859.3**	**851.8**	**997.8**	**1,011.3**	**991.7**	**1,017.6**	**931.1**	**877.5**	**891.9**	**1,081.7**	**1,188.3**	**1,100.5**
Begining Stocks	**125.2**	**36.4**	**16.9**	**76.4**	**160.9**	**170.4**	**135.5**	**186.9**	**132.1**	**91.5**	**81.5**	**168.2**	**181.0**
Production	**665.7**	**717.0**	**667.1**	**420.2**	**483.1**	**537.0**	**410.1**	**305.7**	**411.0**	**520.1**	**700.3**	**938.8**	**786.5**
Center/South	577.6	603.0	585.9	366.8	361.0	449.4	333.7	246.7	385.9	482.8	607.1	861.3	679.9
North/Northeast	88.1	114.0	81.2	53.4	122.1	87.6	76.4	59.0	25.1	37.3	93.2	77.5	106.6
Imports	**86.1**	**105.9**	**167.8**	**501.2**	**367.3**	**284.3**	**472.0**	**438.5**	**334.4**	**280.3**	**299.9**	**81.3**	**133.0**
D E M A N D	**840.6**	**842.4**	**775.4**	**836.9**	**840.9**	**856.2**	**830.7**	**799.0**	**786.0**	**810.4**	**913.5**	**1007.3**	**946.0**
Dom. Consumption	**730.0**	**718.1**	**741.6**	**829.5**	**836.6**	**803.7**	**829.1**	**798.7**	**782.9**	**806.5**	**885.0**	**860.0**	**860.0**
Exports	**110.6**	**124.3**	**33.8**	**7.4**	**4.3**	**52.5**	**1.6**	**0.3**	**3.1**	**3.9**	**28.5**	**147.3**	**86.0**
Final Stocks	**36.4**	**16.9**	**76.4**	**160.9**	**170.4**	**135.5**	**186.9**	**132.1**	**91.5**	**81.5**	**168.2**	**181.0**	**154.5**

Source: CONAB-MAPA/ SRF-MF/ SINDITEXTIL-ABIT/COOPERATIVAS

Prepared by:CONAB/DIGEM/SUGOF

(1) ESTIMATE

(2) FORECAST

TABLE 3

MATO GROSSO STATE: IMPACT OF COTTON ON TAXES AND EMPLOYMENT

FACTORS	SEASON				
	97/98	98/99	99/00	00/01	01/02
Planted Area (ha)	110,177	203,000	268,400	392,000	294,000
Production of Unginned Cotton (tons)	319,163	630,406	908,854	1,376,000	1,049,500
Production of Cottonseed (ton)	197,881	390,852	558,945	842,100	642,300
Production of Cotton Lint (ton)	111,530	242,706	349,909	533,900	407,200
Production of Cotton Lint (arroba)	7,435,333	16,180,421	23,327,253	35,593,333	27,146,667
Sales of Cottonseed for feed use (ton)	60,000	80,000	100,000	100,000	100,000
Sales of Cottonseed to Other States (ton)	137,881	310,852	458,945	742,100	542,300
Sales of Cottonseed for Feed (R$93,00 p/ton)	5,580,000	7,440,000	9,300,000	9,300,000	9,300,000
Out-of-state Cottonseed Sales (R$106,00p/ton)	14,615,392	32,950,282	48,648,192	78,662,600	57,483,800
Average Prices for Cotton Lint (R$ p/arroba)	27.80	35.00	35.00	33.00	33.00
Production of Cotton Lint (R$)	206,702,267	566,314,723	816,453,843	1,174,580,000	895,840,000
State GDP from Cotton	226,897,659	606,705,006	874,402,036	1,262,542,600	962,623,800
ICMS tax (Lint + Seed)	26,558,119	71,911,801	103,812,244	150,389,112	114,398,856
Proalmat Investments	15,920,000	45,871,493	66,132,761	95,140,980	72,563,040
Net Direct ICMS Proceeds	10,638,119	26,040,308	37,679,483	55,248,132	41,835,816
ICMS on Related Services (= 2,73 x Lint+Seed)	72,503,665	196,319,216	283,407,427	410,562,276	312,308,877
Total ICMS Tax Revenue	83,141,784	222,359,524	321,086,910	465,810,408	354,144,693
Direct Employment	11,018	20,300	26,840	39,200	29,400
Indirect Employment	33,053	60,900	80,520	117,600	88,200
Total Employment	44,071	81,200	107,360	156,800	117,600