REPORT OF THE EXECUTIVE DIRECTOR

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to the 60th Plenary Meeting of the

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Introduction

The ICAC is meeting this year for the 60th time during a period of industry crisis caused by the unanticipated decline in cotton prices since December 2000. The Cotlook A Index fell to 45 cents per pound by July 2001, one of the lowest since 1973/74. The level of pain caused to producers and export-dependent countries in 2001 was particularly severe because the fall in prices since December came after five consecutive seasons of declining average values. Not since the 1950s had average world cotton prices fallen for more than two consecutive seasons, and prices had been expected not only to recover in 2000/01 but to continue rising to at least the long run average over the next several years. Consequently, the decline in prices in 2001 was especially shocking, and the impacts have been very harsh.

It is the job of the Secretariat to anticipate major structural changes in the world cotton market, and we did not do this job in a timely fashion prior to the current crisis. Not until April 2001, after cotton prices had already fallen by one-fifth since December 2000, did the Secretariat begin to realize that the changes affecting the market are structural in nature, rather than transient, and that a new understanding of the underlying factors affecting cotton prices is necessary.

The failure to anticipate the decline in prices during 2001 was rooted in observations from the 1990s. Beginning in the mid-1990s, the Secretariat noted that the world cotton yield was not increasing, and that the stagnation in yields was caused by persistent, specific problems with disease, resistance to pesticides and economic dislocation. All of the gain in world cotton production between 1950/51 and the early 1990s resulted from increases in yields. Between the 1950s and the 1990s, world cotton area varied within a relatively narrow range. Therefore, with the world yield no longer climbing in the 1990s, it seemed that world production would not expand. With economic growth and increases in population leading to a rise in cotton use, the Secretariat expected that demand would climb while supply did not, resulting in above-average cotton prices in most seasons.

This basic view of world cotton fundamentals (stagnant supply confronting rising demand, resulting in above-average prices) seemed accurate in the mid-1990s when the Cotlook A Index climbed to more than $1 per pound. The decline in prices during 1995/96, 1996/97 and 1997/98 seemed justified by the rise in production after 1994/95, and few had expected that the exceptional prices of 1994/95 would be sustained. When prices continued lower in 1998, the fall was rationalized by the Asian financial crisis that began in 1997 and by lower imports by China (Mainland). When prices continued lower still in 1999/00 for a fifth consecutive season, the explanation again was trade policies in China (Mainland) and additional currency devaluations in Russia and Brazil.

But, if the expectation of tight supplies and rising prices was valid, after five consecutive seasons of falling prices, prices would rise in 2000/01. And indeed the Cotlook A Index did rise in 2000, climbing to 66 cents by December and seeming to validate the expectation that prices would be above average in most years. The Secretariat expected the Cotlook A Index to continue higher in 2001, and prices close to the long run average of 73 cents were expected by 2001/02. But then, the sharp decline in prices this year that carried the A Index to less than 50 cents per pound forced a questioning of the basic assumptions that world supply was stagnant while demand was rising.

The expectation that stagnant supply would confront rising demand was partially right; world cotton demand rose to a record in 1999/00, and additional growth is expected over the next two seasons as world economic growth improves and current cotton prices encourage increased cotton use. Nevertheless, demand is rising slowly at just 1% per year, compared with average increases of 2% per year prior to the 1990s. However, the expectation that supply is stagnant does not seem to be valid. World production rose in 2000/01 to more than 19 million tons, and production is forecast to increase to 20 million tons in 2001/02, despite prices near the lowest levels in 28 years. In economic terms, the world cotton supply curve seems to be moving to the right, meaning that even at current prices, production is rising.

Four Factors Expanding Supply

Four factors seem to be influencing the shift in the level of world cotton supply: Improved technology, the strength of the U.S. dollar, the development of new cotton area and government measures. The most visible of the new technologies is genetic engineering. GE varieties already account for 16% of world cotton area and is the most rapidly adopted technology in the history of agriculture. The primary impact of GE varieties is not higher yields. Instead, the technology is primarily risk-reducing and cost-reducing, leading to larger area and greater production. The most significant impact of the Bt varieties that provide bollworm resistance has been in China (Mainland). Production in East China, affected in the early 1990s by resistance among bollworms, climbed about 300,000 tons between 1999/00 and 2000/01 largely because of the adoption of Bt varieties. GE varieties account for about 30% of area in China and Australia, and two-thirds of area in the USA, and field trials are underway in other producing countries. Incremental advances in proven technologies such as irrigation management, pesticide formulations and pesticide applicators, low till and no till production systems, crop rotations and other management techniques are also contributing to lower production costs and expanded cotton production, despite three consecutive seasons with average prices of less than 60 cents per pound.

The strength of the U.S. dollar is encouraging increased production in those countries where currencies have depreciated. The U.S. dollar rose by about one-third against the Australian dollar in the past three years, by 90% against the Brazilian reais, by one-fourth against the currency of Francophone Africa, and by 500% against the Turkish lira. Thus, while cotton prices measured in U.S. cents per pound are among the lowest in 28 years, prices in the currencies of producers outside the USA are somewhat more attractive.

The development of new areas for cotton in Brazil and Turkey are contributing to the rise in world production. Production costs in Mato Grosso are estimated well below the world average, and production has climbed from 30,000 tons to 480,000 tons in Mato Grosso since the mid-1990s. The expansion of irrigation in East Turkey is well documented, and the GAP region now accounts for 430,000 tons of production, compared with 164,000 tons in 1994/95 when the Cotlook A Index averaged more than 90 cents per pound. Together, Mato Grosso and East Turkey are accounting for an additional 700,000 tons of world cotton production that is still expanding, even at current prices, and that did not exist in 1994/95.

Measures by governments to support farmers and domestic production during periods of economic stress are also affecting the world cotton supply. The Secretariat estimates that U.S. cotton production would be reduced by about one-fourth in the absence of the U.S. cotton program, and production in the EU would probably drop by three-fourths without the income support program. China (Mainland) is also known to support domestic prices above market levels, and a withdrawal of subsidies would probably result in lower production. Mexico, Brazil, Egypt and Turkey also have modest programs that support cotton farmers. In total, measures by governments are boosting world production by an estimated two million tons over what would be produced at current prices in the absence of the measures.

One implication of rising world production is that a recovery in prices to average levels is not likely soon. Secretariat estimates of season averages of the Cotlook A Index are below 60 cents per pound over the next two seasons. Obviously, weather can change the outlook for prices from season to season. But rather than an underlying expectation that cotton prices will tend toward levels of 80 cents per pound, it now seems more likely that the average level of prices will be well below the average since 1973/74 of 73 cents per pound. Low prices will ultimately benefit consumers, and the rate of growth in world cotton consumption may move back toward 2% per year, as was common prior to the mid-1980s. However, continued low prices are obviously going to put additional pressures on producers, leading to less intensive input use, continued efforts to lower costs through technology and sharpening diplomatic conflicts over government measures.

Role of the ICAC

The mission of the ICAC is to assist governments in fostering a profitable and healthy world cotton industry. The Committee serves as a catalyst for cooperative action by governments and industry segments in the pursuit of broadly shared goals. The role of the ICAC is to raise awareness, disseminate information and to facilitate cooperative action. The theme of this 60th Plenary Meeting is "COTTON – An African Renaissance," an ambitious theme, given the current level of world prices. However, it is instructive to note that in Zimbabwe, and in other countries of East Africa, production is tending higher even now, despite low world prices, making it particularly appropriate that the Committee is meeting here this year. There are seven topics that will receive emphasis this week, and our broad objective is to expand understanding and cooperation in these areas: Government Measures, Demand Enhancement, Good Trade Practices, Improving Quality, Genetic Engineering in cotton, and Integrated Crop Management.

Government Measures

The subject of government measures in cotton has been discussed in the ICAC since the creation of the Committee in 1939. One concern is that these discussions have often been more contentious than constructive. It is my hope that by limiting calls for removal to those measures that directly distort production and trade, discussions this year can be better focused and therefore more productive.

Reports by the Secretariat indicate that government measures have an impact on the structure of the world cotton economy. 55% of world cotton production benefited from direct income or price support programs in 2000/01, and cotton area in countries that provide direct subsidies to growers increased from 11 million hectares in 1998/99 to 11.7 million in 2000/01. In contrast, cotton area in countries that do not provide direct subsidies to growers declined from 22 million hectares in 1998/99 to 20 million in 2000/01.

The Standing Committee expressed concern about domestic policies that distort cotton prices and trade and has developed a resolution urging WTO negotiators to move forward with constructive proposals to reduce trade and production distorting policies. The Private Sector Advisory Panel echoed these sentiments during a round table discussion with the Standing Committee in June in Washington. The PSAP noted that governments seek to achieve many valid objectives through the use of measures affecting agriculture, and that it is not realistic to expect the immediate elimination of all forms of government measures. Therefore, the PSAP suggested that the ICAC focus its efforts on achieving a gradual but steady reduction in those government measures that directly subsidize increased cotton production.

The resolutions put forward by the Standing Committee are contained in Working Paper III that will be discussed during the Third Plenary Session. The objective of the session on government measures is to develop a unified position that countries can communicate to their WTO negotiators as a consensus on which the cotton industry can build.

In a related matter, Working Paper II contains a recommendation from the Standing Committee encouraging the adoption of good trade practices and urging governments to make valid arbitral awards enforceable under member country's laws. Adoption of this recommendation during the Second Meeting of the Steering Committee will help to bolster confidence in the cotton trading system and improve the efficiency of the world cotton market.

Cotton Quality

Improvements in cotton quality are a long-standing concern of the textile industry, and the decline in average prices is increasing the incentives for producers to enhance returns by earning quality premiums. The First Open Session will be on the subject of Improving Cotton Quality. One element in efforts to improve quality is the development of recommendations on cotton ginning. The Standing Committee authorized the creation of an expert panel on ginning methods in January. The efforts of the Expert Panel are much appreciated. There will also be reports on methods to reduce contamination in cotton, the impact of genetic engineering on quality and the role of fiber testing in improving quality. The objective of the session is to identify policies and programs governments can adopt to best encourage improved cotton quality.

Demand Enhancement

Slow growth in demand for cotton must be a concern of all segments of the cotton industry. The subject of demand enhancement will be discussed on two levels during the Second Open Session. On one level, the Committee will hear of efforts by national cotton industry organizations to expand efforts to boost retail demand for cotton. On a second level, there will be a report on measures to boost mill use of cotton in Africa, and by implication in other developing countries.

The world cotton industry has a long history of unsustained international efforts to promote increased consumption of cotton. While there has always been broad agreement in theory that promotion is necessary to the health of the world cotton industry, in practice there has been a lack of will to provide sufficient funds to sustain international efforts. Therefore, the Consortium for Cotton Promotion represents a different approach looking to build on the success of national programs. An objective of this year's session on demand enhancement is to empower additional cotton industry organizations to begin national campaigns of cotton promotion in their countries.

Mill use represents just half of production in Africa, and in many developing countries all production is exported. There are positive steps that governments and industries can take to foster an improved investment climate for textile industries, and these steps will be discussed in the session on demand enhancement.

Genetic Engineering and Integrated Crop Management

As noted earlier, genetic engineering and advances in other production technologies are contributing to lower production costs and expanded world production. But the new technologies are not evenly available to all producers, and some are not appropriate in all situations. As with any new technology, there is much to learn about the use of genetically engineered products. The Third and Fourth Open Sessions will be devoted to discussions of the new technologies and their impact on producers, particularly producers in Africa and other developing countries. The objectives of the sessions are to provide for widespread adoption of appropriate technologies and to evaluate whether the new technologies are well suited in all cases.

Work of the Secretariat

There have been many areas of accomplishment by the Secretariat in the past year, and I want to acknowledge the efforts of members of the Secretariat to improve services to governments and the cotton industry and to expand the amount of information provided. The Secretariat provided daily, monthly and annual statistical reports on the world cotton situation that detailed ongoing changes in the world industry and likely trends over the next several years. The Secretariat produced significant reports on government measures, the demand for cotton, the structure of trade and the level of export commitments. There have also been technical reports on cotton research. The Secretariat has helped to organize regional technical meetings, and has assisted with preparations for the WCRC-3. The Secretariat coordinated the formation of the Expert Panel on Ginning Methods and helped to expedite the work of the Panel. The Secretariat has served as the International Commodity Body for Cotton before the Common Fund for Commodities. In partnership with Coordinating Agencies in Poland and Germany, the Secretariat expanded the range of information available on the ICAC web site and continued to make the site easier to use.

Plenary Meetings

The purpose of a plenary meeting is to meet and move forward through agreements to cooperate and improve. Meetings are also for the exchange of information regarding the outlook for cotton supply, use and prices, changes in government measures affecting the cotton industry and reports from countries and organizations. The Zimbabwe Organizing Committee has worked with the Secretariat and the Standing Committee to orient the agenda of this 60th Meeting to focus on matters of broad concern to producers and spinners in Africa, and by extension to bring attention to problems facing all segments of the world industry. It is a pleasure to be able to thank the Organizing Committee and the Government of Zimbabwe for their efforts in preparing for this meeting and for their hospitality. Zimbabwe has had great success in raising production, making it highly appropriate that we are meeting here this year.

I also wish to recognize the efforts already underway in Egypt and Poland to host the 61st and 62nd Plenary Meetings in 2002 and 2003. Egypt formed a host organization early in 2001 and has been actively preparing for next year. The Mina House Hotel beside the pyramids and sphinx in Cairo will serve as the conference facility. The Organizing Committee in Egypt includes representatives of all segments of the cotton industry, including many people who are very familiar with the ICAC and have long supported the work of the Committee. I look forward to traveling to Cairo next month to consult with the Organizing Committee and government officials on preparations for next year. Likewise, preparations are already well advanced in Poland to host the meeting in September 2003. A theme and conference venue are being identified, and the government and cotton industry of Poland will ensure that the meeting is highly successful.

New Members

I want to welcome delegates from non-member countries who are participating as observers. All participants in ICAC plenary meetings are fully welcome, and I hope you will consider joining the Committee. Membership in the ICAC is of value to all countries that produce, consume or trade cotton. Membership provides tangible benefits in the form of increased access to statistics and technical information provided by the Secretariat. Membership in the ICAC can lead to increased funding for cotton research through the Common Fund for Commodities. And, most importantly, membership in the ICAC provides the avenue for each cotton industry, including cotton textile industries, to join fully into the fraternity of cotton countries in discussions of cotton issues of international scope and significance.

ICAC Institutions

I want to acknowledge the work of the Standing Committee this past year. The Standing Committee monitored the development of the business plan and for the first time approved the use of business plan revenue for additional services. The Standing Committee approved the conditions for creation of an Expert Panel on Ginning Methods, shaped the priorities reflected in the agenda of this plenary meeting, passed resolutions on government measures and good trading practices, and dealt with matters of budget and management. Each subject was handled with discretion and expertise. The four institutions of the ICAC, the Advisory Committee, the Standing Committee, the Private Sector Advisory Panel and the Secretariat, are working well together. The Standing Committee, and its officers this past year, Mr. Blum, Mr. Liévano, and Mr. Malhotra, deserves much credit for their work. I also want to thank Mr. Stanley Anthony who serves as Chair of the Expert Panel on Ginning, and Mr. Fritz Grobien, who serves as Chair of the Private Sector Advisory Panel. The Expert Panel and the PSAP have contributed much to the work of the ICAC this year. Let me also acknowledge the work of the Common Fund for Commodities in support of the cotton industry. The Common Fund has approved a total of nine cotton projects involving over $20 million in grants and loans. A marketing project is underway here in East Africa, and a newest cotton project on price risk management will be inaugurated this week. The work of the CFC under Managing Director Rolf Boehnke is much appreciated.

I thank member countries for the privilege of serving as executive director, and I look forward to a successful 60th Plenary Meeting.