PRODUCTION AND TRADE POLICIES AFFECTING THE COTTON INDUSTRY

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UPDATE TO GOVERNMENT MEASURES AFFECTING COTTON PRODUCTION, GINNING AND TRADE

Introduction

The level of direct assistance to production provided by governments is estimated to have declined from US$4.8 billion in 1999/00 to US$3.6 billion in 2000/01. Subsidies in 2000/01 ranged from an estimated US$14 million provided by Mexico to US$1.9 billion provided by China (Mainland). Assistance per pound of lint in 2000/01 ranged from 85.5 U.S. cents in Spain to 2.3 U.S. cents in Brazil. Production estimates and additional information gathered by the Secretariat suggest that 55% of world cotton production benefited in 2000/01 from direct income or price support programs, 2 percentage points more than in 1999/00.

European Union

Under the Common Agricultural Policy of the European Union, support payments are made to ginners who are required to pass the subsidy in the form of higher prices to growers. Advance payments are based on estimates of seedcotton production and the difference between market prices and a published guide price. The policy also influences the quantity of cotton produced by a maximum guaranteed quantity of seedcotton for which assistance is provided. The maximum guaranteed quantity is 782,000 tons of seedcotton for Greece and 249,000 tons for Spain.

The European Union reformed the existing cotton subsidy program in late 1999. While the guide price level and the maximum guaranteed quantity of seedcotton for which assistance is provided have been maintained, penalties for excess production over the maximum guaranteed quantity increased. Under the new system, for each 1% excess production, the level of subsidy is lowered by 0.6% of the guide price (as opposed to 0.5% in previous years). The cotton growing regions of Greece and Spain are among the lowest-income regions in the EU, and income support is viewed as a form of economic assistance. Total direct assistance offered by the EU to cotton growers amounted to 853 million euros, comparable to US$794 million, and it is estimated to have declined to US$716 million in 2000/01.

China (Mainland)

The government of China (Mainland) provided an estimated US$1.5 billion in assistance to growers in 1999/00. As of September 1, 1999, new policies in China (Mainland) allow domestic cotton prices to be influenced by market factors. The government still sets a reference price for cotton. Nonetheless, actual prices are now negotiated between buyers and sellers and can go below or above the reference price. For 2000/01, the government of China (Mainland), with a policy of stock reduction, has maintained domestic prices well above international prices. Domestic prices in China (Mainland) were consistently above 11,000 yuan per ton (60 U.S. cents per pound) in 2000/01 and increased 5% to 12,000 yuan per ton (66 U.S. cents per pound) between January 1st and mid-March 2001, a period when the bulk of the crop is traded. It is estimated that growers in China (Mainland) obtained US$1.9 billion in assistance in 2000/01.

USA

Cotton growers in the U.S. received a total of US$4 billion in government subsidies in 1999/00. About half of this amount was given in direct assistance through two different mechanisms, a Loan Deficiency Payment (LDP) and a Production Flexibility Contract Payment (PFCP). The LDP is the difference between the average loan rate and a weekly Adjusted World Price (AWP). The PFCP is a fixed payment to compensate growers for the loss of previous assistance linked to prices. Total LDP for 1999/00 was US$1.5 billion. The flexibility payment provided to growers was US$572 million in 1999/00. Additional payments under the PFCP mechanism, which account for disaster relief, amounted to US$1.2 billion. Other payments to growers in 1999/00 amounted to US$700 million, which covered the export and consumption subsidy program known as Step 2, as well as storage and interest costs of the cotton in the loan. Excluded from the US$4 billion offered in 1999/00 is credit guarantees offered to importers of U.S. cotton. In 1999/00, the U.S. government exercised US$2.9 billion in credit guarantees to agricultural exports, of which 13% (or US$380 million) were exercised for U.S. cotton. It is estimated that the U.S. government provided US$759 million in direct assistance in 2000/01.

Turkey

All growers in Turkey are entitled to a premium payment calculated on the basis of seedcotton deliveries to either cooperatives or private gins. With this program in place the Turkish government support was US$287 million in 1999/00 and is estimated at US$106 million for 2000/01.

Egypt

The government of Egypt announced that the floor price mechanism offered to growers in the past was to be discontinued for 1999/00. Nonetheless, as world prices declined in 1999/00, the government disbursed US$20 million in order to pay for the difference between selling and purchase prices. In 2000/01, the government provided an estimated US$23 million.

Brazil

In 1999/00, the government provided R$78 million, equivalent to US$44 million, to secure prices to farmers above minimum prices through options exercised by farmers. As domestic prices fell below the support level of R$28.6 per arroba (15 kilograms), the government allocated R$100 million (US$44 million) for government acquisition of cotton in 2000/01.

Although the Brazilian government sets a minimum guaranteed price, there is no automatic budgetary allocation to allow direct purchases by the government. In the past, there was a loan program (AGF) which required the government to purchase cotton when prices fell below the minimum price. This program is no longer in existence, except for officially declared disasters.

Mexico

In 1999/00, the Mexican government provided assistance to growers at a rate of US$188 per hectare dedicated to cotton, equivalent to about 9.5 U.S. cents per pound with an average yield. Total direct assistance provided by the Mexican government was US$28 million in 1999/00. Assistance to growers was given in 2000/01 at a rate of P$1,888 per hectare, comparable to US$194 per hectare for a total government assistance of US$14 million.

Level of Assistance Provided by Governments to the Cotton Sector Through Production Programs *

	1999/00			2000/01		
Country	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
USA	3694	25.2	2056	3749	9.2	759
China (Mainland)	3829	15.4	1534	4350	19.5	1936
Greece	428	63.1	596	420	57.9	537
Turkey	791	16.5	287	750	6.4	106
Spain	130	69.3	199	95	85.5	179
Brazil	700	2.8	44	850	2.3	44
Mexico	135	9.5	28	71	8.9	14
Egypt	233	3.9	20	201	5.2	23
All countries	9940	21.7	4764	10486	15.6	3597

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

Initiatives in Other Countries

Average international prices were below 60 cents per pound in 2000/01 for the third consecutive year. The average of the last 25 years was 72.5 cents, which is considered an equilibrium price for the cotton market. Normally, when prices decline below the long-term average, production declines follow. In 1992/93, season average international prices, as measured by the Cotlook A Index, declined to 58 cents and the following year world production declined to just below 17 million tons. In 1998/99, 1999/00, and 2000/01, world production remained at about the same level of 18.8 million tons. Area dedicated to cotton production in countries that do not provide direct subsidies to growers declined from 22 million hectares in 1998/99 to 20 million in 2000/01. However, area dedicated to cotton in countries that provide direct subsidies to growers increased from 11 million hectares in 1998/99 to 11.7 million in 2000/01. Further, the continued very low level of prices over three seasons has bankrupt many producers in developing countries and threatens to increase the unemployed population in urban areas, as dispossessed cotton growers migrate to the cities. In an effort to contain migration of farmers, some governments have developed emergency programs aimed at maintaining farmers in their land. Along these lines, the government of Argentina pledged in mid-May 2001 to provide up to US$100 per hectare to farmers producing cotton and other crops. Nonetheless, as the country is currently registering an economic crisis, it is uncertain whether the Argentinean government will have the funds to fulfill its pledge. Similarly, under the same circumstances as in Argentina, the government of Colombia agreed to guarantee a minimum price of P$2.7 million per ton (55 U.S. cents per pound) for cotton production in the Northern Hemisphere schedule. As prices in December 2000 and January 2001, when the crop was commercialized, were above the guaranteed price no government disbursement was exercised. Production under the Southern Hemisphere schedule was not covered by the agreement. The government has not announced plans to extend the agreement to the 2001/02-crop year.

Direct Assistance to Exports

Only two countries, China (Mainland) and the USA, provide subsidies to exports of cotton. Overall assistance provided by these two countries amounted to US$286 million in 1999/00 and is estimated to have declined to US$114 million in 2000/01. Exports are subsidized in China (Mainland) through direct payments made by the central government to exporting agencies. The direct payments are designed to bridge the difference between international market prices and the internal cost of buying, ginning and transporting cotton to an export location. Assistance in the USA averaged 5.6 cents per pound in 1999/00 and is expected to average 2.5 cents per pound in 2000/01.

As of October 1,1999, the U.S. government approved legislation making available about US$10 million for Pima cotton. The mechanism by which a payment rate is made compares the difference between a five-day average spot U.S. Pima price with the lowest priced competitor in Northern Europe adjusted for quality and transportation.

A Measure of the Impact of Subsidies on Prices

It is certain that a removal of subsidies would result in lower production and, thus, higher prices in the short term, but such an impact would be offset, either partially or totally, by shifting world production to non-subsidizing countries in the medium and long terms. Similarly, higher prices would reduce the growth of cotton consumption.

Since no model is likely to capture all of the effects, a number of assumptions has to be made. First, a joint study by FAO and ICAC suggests the price supply elasticity for a number of countries, but the elasticity for the USA is the only one with a good degree of accuracy. Second, demand response to higher prices resulting from a removal of subsidies can be measured by the price demand elasticity provided by the ICAC World Textile Demand Model. Third, a measurement of the response of other countries to higher prices resulting from a removal of subsidies has to be assumed. Further, if only the impact of U.S. subsidies is to be simulated, a reasonable measure of potential U.S. production without subsidies has to be assumed.

In an effort to explore the likely impact of a removal of U.S. subsidies it was assumed that given the historically high international prices in 1994/95, U.S. production that season is a good measure of the potential production without subsidies. A price supply elasticity (0.47) for the following years was applied to production, which resulted in an estimated 2.8 million tons of cotton production in

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

Country	1999/00			2000/01		
	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	1470	5.6	180	1570	2.5	85
China (Mainland)	370	13.0	106	100	13.0	29
All countries	1840	7.1	286	1670	3.1	114

1999/00, 900,000 tons lower than actual production, and 3 million tons estimated for 2000/01, 700,000 tons less than currently estimated. When applied to the ICAC Price Model, the decline in U.S. production would result in average international cotton prices 6 cents higher than realized in 1999/00 and 12 cents higher than expected in 2000/01.

Higher prices would have an impact upon demand for cotton. The ICAC World Textile Model suggests that a 20% increase in cotton prices would result in a 1% decline in world demand for cotton. The resulting levels of demand were applied to the price model suggesting that lower levels of demand would lessen the initial impact by 1 cent in 1999/00 and 2 cents in 2000/01.

There is no doubt that with higher prices production in non-subsidizing countries would increase. However, there is no measure to assess the impact. With relatively high prices (above the long-term average of 72.5 cents), area dedicated to cotton in non-subsidizing countries increased to 22 million hectares in 1998/99. Area declined to 20.7 million hectares in 1999/00. If prices had been 6 cents higher in 1998/99, the price decline would have been only half compared to 1997/98 and thus it is reasonable to expect that area would have declined just by half. Such a response would offset half of the production decline that would have resulted from an elimination of subsidies in the U.S. As a result, the impact of a removal of U.S. subsidies would have an estimated net positive effect of 3 cents on average cotton prices in 1999/00, and 6 cents in 2000/01. If it is assumed that subsidized production in all countries would respond as in the theoretical exercise for the U.S., the impact of a removal of direct subsidies worldwide would have an estimated net positive effect of 17 cents on average cotton prices in 2000/01.

It is reasonable to expect that a removal of subsidies would result in less variation in season average prices from year to year, but little effect would take place in the long-term as production would shift to other countries.

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