PAKISTAN COTTON MARKET – AN OVERVIEW *

I. Historic Perspective

Cotton pricing/marketing practices in Pakistan have undergone radical change since independence of the country. In the early days, the entire marketing activities depended on the Cotton Exchange, and at the head of the entire marketing system was the Karachi Cotton Association which regulated the cotton trade. Both 'spot' and 'future' markets were operated at the Cotton Exchange. The spot market made it possible to buy and sell cotton in advance through contracts and provided facilities for hedging. Price of lint ruling in the Cotton Exchange determined the seed cotton price, which was paid by the ginners or merchants to the grower for his produce. At the time, when the local textile industry was in the stage of infancy, prices were largely dependent on the export market. As the domestic textile industry grew in size and export of cotton yarn increased, the influencing factor became the price of cotton yarn. Due to ready demand from the textile industry cotton prices generally maintained a steady level. The local prices were protected through the levy of export duty, and as a matter of official policy exports were confined to the exportable surplus.

The futures or Hedge market continued to operate under the supervision of KCA till December 1975. It was then suspended and later closed through a government directive. This was done to stop wide and unwarranted price fluctuations and speculation. It was in this context that for the first time government decided to fix seed cotton and lint prices to protect the interest of the growers and to bring about stability in the market. By 1980, the Government fully appreciated the importance of price policy in agricultural development and of a more scientific basis for fixing of the support price. Therefore, in 1981 the Agricultural Prices Commission was instituted to secure an objective basis for recommendations to Government on prices and related "non-price" matters.

II. Support Prices

The main objective of recommending support price of various agricultural commodities including cotton has been to :

i) help raise the production and productivity of a crop for import substitution,
ii) induce production and productivity of exportable crops to raise foreign exchange revenue,
iii) safeguard the interest of the farmers against falling prices in the post harvest months particularly when the harvest is a bumper one, and
iv) help stabilize inter-year and intra-year prices.

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The support price computation is primarily based to cover the average production cost per unit of area and to compensate for the increase in the prices of inputs, particularly the labor, fertilizers and pesticides. This has, however, been a notional price as the market price of both seed cotton and lint by and large remained much above the support level. The mechanism envisages government's intervention only if the market prices tend to fall below the support level. A comparison of the two prices in figures I & II shows the difference:

Fig: I

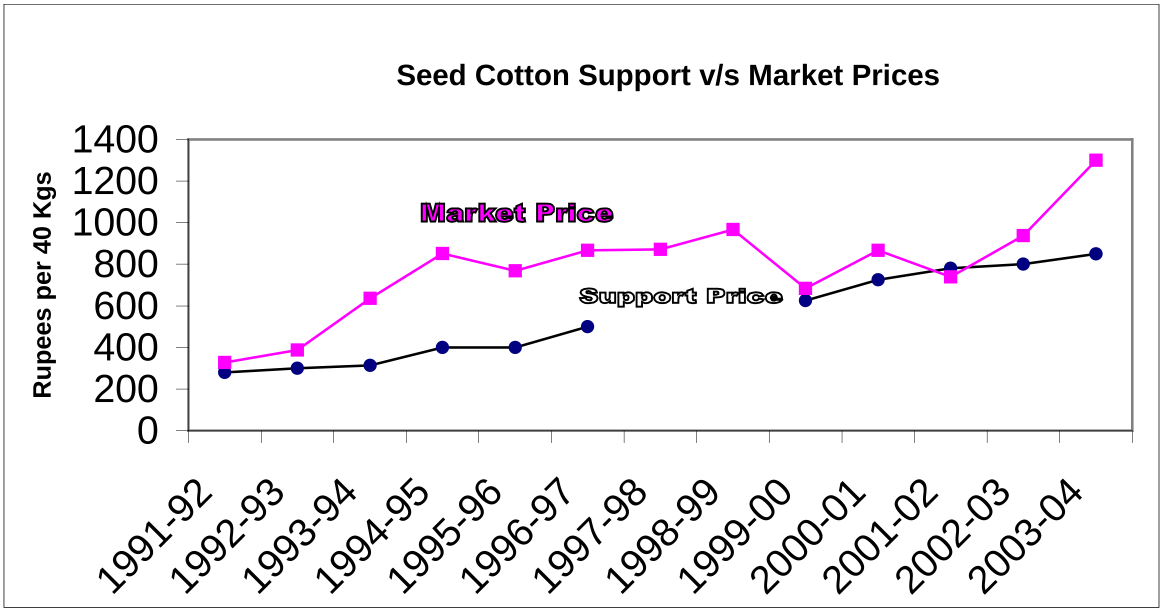
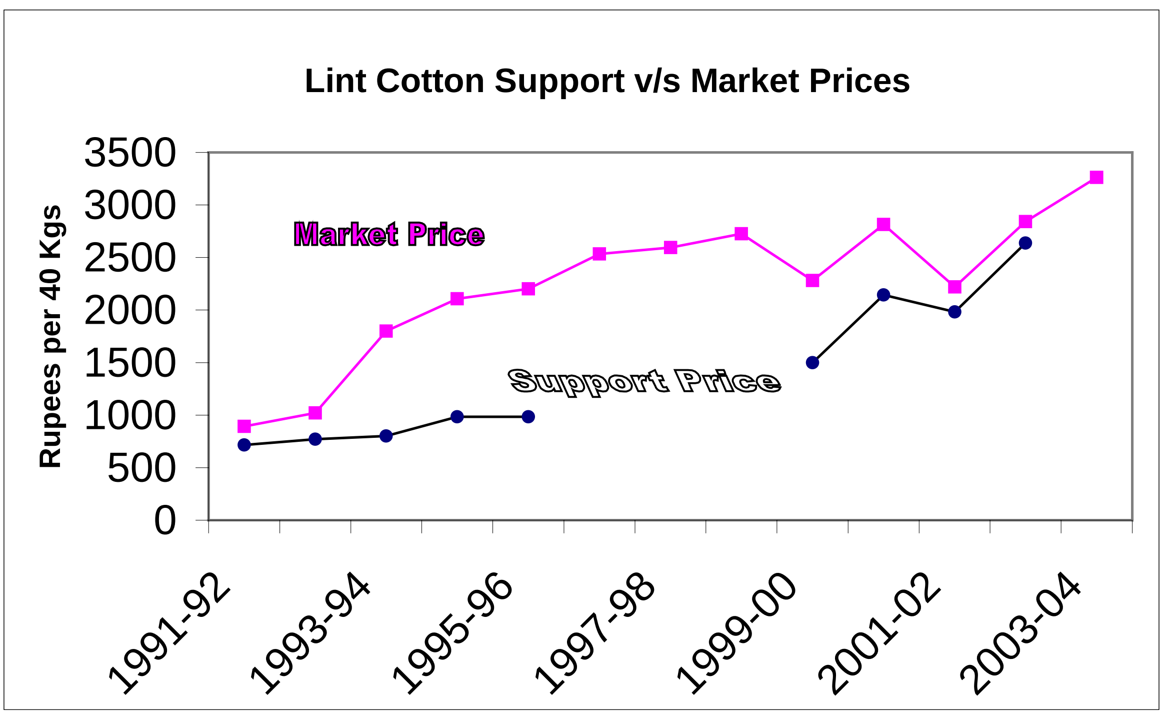


Fig: I I



The season 2001/02 was, however, an exception when the seed cotton market price had remained much depressed due mainly to large imports made by the spinners taking advantage of the international market price which in that particular season had averaged at 39.31 cents per pound (Cotlook B Index) as against 52.93 cents of 2000/01. In the later part of the season the government had inducted the Trading Corporation of Pakistan to commence procurement. But, by that time a number of growers had to sell their produce at through away prices for hard cash

III. Government Intervention

Government intervention in cotton marketing has primarily been to stabilize the market so as to save the growers from any significant economic loss. Since 1991/92 the government procurement was made only on six occasions. The purchase quantum in these years is shown in the following table: :

TABLE # I **Government Procurement of Raw Cotton Since 1991-92**

(million bales of 170 Kgs. Each)

Years	Cotton Production	Govt. Procurement	Procurement as % of Production
1991-92	12.822	2.518	19.64
1992-93	9.054	0.028	0.31
1993-94	8.041	0.155	1.93
1994-95	8.697	-	-
1995-96	10.595	-	-
1996-97	9.374	-	-
1997-98	9.184	-	-
1998-99	8.790	-	-
1999-00	11.240	0.491	4.37
2000-01	10.732	0.011	0.10
2001-02	10.612	0.245	2.31
2002-03	10.211	-	-
2003-04	10.100*	-	-

* Estimated.

It may thus be seen that except for the year 1991-92 when the government agency had to lift a sizeable quantity, the magnitude of this intervention in general has been only marginal. It is pertinent to mention here that the occasional government intervention had also positively contributed towards the qualitative improvement both in the supply of seed cotton and the ginning process.

IV. Custom Ginning

In order to avail the better returns through cotton production, custom ginning is also being considered and advocated as a better option for the growers to enter into cotton business rather than confining to the growing of cotton. But, under the present situation, it seems an idealistic proposition mainly because of small outputs of a large number of small farmers running 81 percent farms of under five hectares and occupying 39 percent of the area. It may, however, still be a viable and payable option for those who can make it possible by forming village cooperatives for mutual benefits. It is estimated that the growers' income from cotton may enhance by 10 to 15 percent by switching over to custom ginning. This may also help in reducing to a greater extent the problems of varietal admixture and the higher non-lint contents. Some of the farmers of medium and large holding group are already engaged in custom ginning.

V. Moving Focus

The stakeholders, however, now seem convinced that the cotton price determination may be left with the market forces. The growers also insist on valuing their produce in accordance with the prevailing international market prices, and in case of higher world market prices its benefit should also be passed on to them. The government has, therefore, adopted a free trade policy in cotton with no quantitative restriction or duties on its import or export so as to provide a level playing field to all the stakeholders. This has, however, resulted in higher imports on the plea of rising mill consumption and growing necessity of clean / contamination free cotton, as depicted by the following figures :

TABLE # II **Cotton Production, Imports and Exports Since 1991-92**

(million bales of 170 Kgs. Each)

Years	Production	Imports	Exports
1991-92	12.822	0.025	2.547
1992-93	9.054	0.033	1.498
1993-94	8.041	0.627	0.325
1994-95	8.697	0.645	0.215
1995-96	10.595	0.156	1.807
1996-97	9.374	0.182	0.210
1997-98	9.184	0.301	0.509
1998-99	8.790	1.314	0.009
1999-00	11.240	0.421	0.586
2000-01	10.732	0.670	0.709
2001-02	10.612	1.080	0.268
2002-03	10.211	1.138	0.260
2003-04*	10.100	1.200	0.200

* Estimated.

With reference to imports, it is important to mention that Pakistan has now emerged as the largest importer of PIMA cotton. The growers' and ginners' lobbies have been stressing upon the government not to allow the import of medium long and long staple cotton that remains abundantly available in the local market and such imports in turn depress the local market prices to their disadvantage.

VI. Hedge Trading

In 2002, the then Federal Minister for Commerce had constituted a formal Committee headed by the Chairman, Karachi Cotton Association with other stakeholders as its members to formulate necessary modalities for resuming hedge trading in cotton. The Committee submitted its report in June, 2002. The salient features of the report are as under :

1. Hedging is a device to cover the risk of fluctuations in prices of cotton which could be availed of by all sections of the cotton trade including the growers.

2. It would be optional and not compulsory.

3. The existing support price system may not be affected on the resumption of hedge trading. In fact, the support price system was introduced to stabilize the market at a certain level and the prices would be automatically determined by the free play of demand and supply once that level was achieved.

4. The utility, benefits and advantages of hedge trading in cotton had been reaffirmed by the three official Hedge Contract Enquiry Committees set up by the government in the years 1953, 1965 and 1971.

5. Under the amended By-laws of the Karachi Cotton Association, cotton is tenderable against the hedge contracts in all the registered ginning factories in the country, and also in all textile mills as well as within the municipal limits of various cities having dry ports.

6. With the free trading policy in cotton in vogue, cotton could be imported within a few days from the nearest point and tendered against the hedge contracts thereby avoiding risk of squeeze, bullish or market manipulation.

7. The hedge contract proposed to be introduced contains some unique features in as much as Pakistan origin cotton has been made tenderable in the registered ginning factories in the upcountry which are members of Pakistan Cotton Ginners' Association so as to encourage various sections of the cotton trade in the upcountry to take advantage of the hedging facility to cover their risk of fluctuations in prices of cotton. Apart from that, imported cotton has also been made tenderable which would put a check on market manipulation, if any, or bullish behavior in the market which could be caused by the failure of the cotton crop or shortage of the crop on account of unfavorable weather conditions such as rains, floods and damage to the crop by insect and pest attack. This will help to exercise an effective check on market manipulation if any or the bullish behavior of the market and keep the contract under control.

8. In order to exercise an effective control on hedge market, there should be a regulatory body which could be Cotton Board of the Government of Pakistan to make sure that the rules are strictly followed.

9. The necessary frame-work, expertise, requisite experience, Trading Hall and manpower including brokers are already available with the KCA and the By-laws relating to the cotton hedge contract have been up-dated and improved to conform with the present conditions and requirements.

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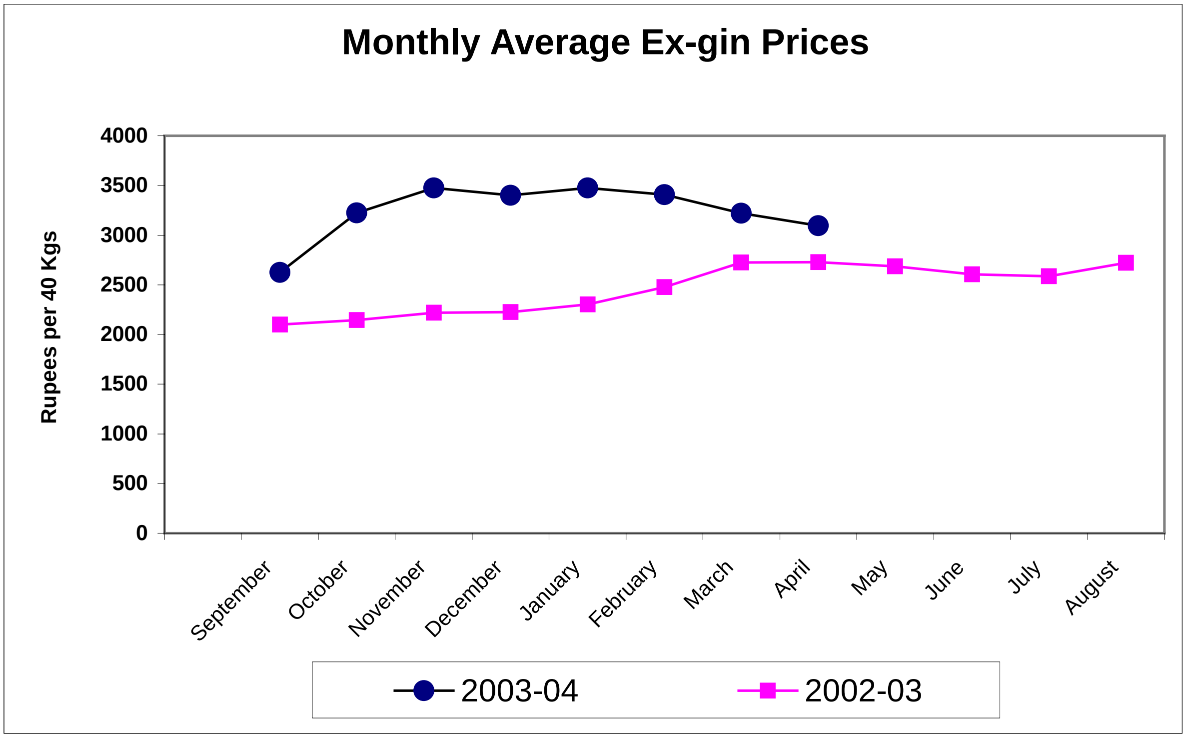
VII. Tail Piece

This season (2003/04), seed cotton market prices remained exceptionally higher through out, hence a good season for the growers despite considerable yield losses caused by unprecedented flare-up of Army worms and heliothis. The overall situation for the ginners was, however, otherwise. The lint cotton ex-gin rates moved almost parallel to the world market trend and remained comparatively much above the last year's level, as is evident from figure III.

Fig: III



The higher imports on apprehension of much a lower crop by the spinners further added to be difficulties of the ginners. The crop however turned out to be over ten million bales. Consequently, the unsold stocks with the ginners as on 1st April, 2004 were of the order of 1.231 million bales as against 0.676 million bales reported on the same date last year (2002/03). The ginners are, therefore, pleading for government's intervention to get them out of the crisis, particularly when the situation has emerged due to unusually high prices paid for seed cotton. As mentioned earlier, such a disappointing situation was also faced by the growers in 2001/02 when the seed cotton market prices had shrunk to their much disadvantage.

It thus implies that there is no proper mechanism for price risk coverage in the prevailing cotton marketing system in the country. Hence, there is ample scope for the resumption of hedge trading in cotton in near future.

Cotton Production, Imports and Exports

(million bales of 170 Kgs. each

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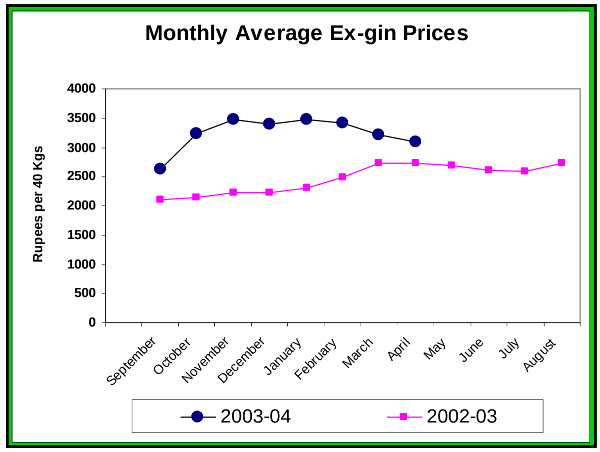

Conclusion

- No proper mechanism for Price Risk coverage
- Scope for resumption of hedge trading

Thanks