INTERNATIONAL COTTON ADVISORY COMMITTEE

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PRODUCTION AND TRADE POLICIES AFFECTING THE COTTON INDUSTRY

September 2011

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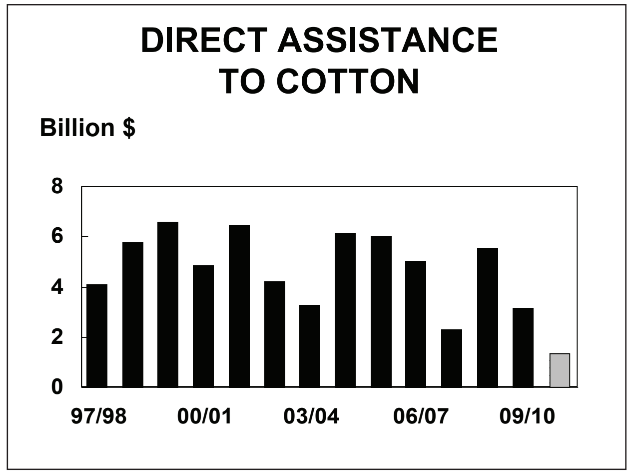
A report by the
Secretariat of the
International Cotton Advisory Committee

Washington DC, USA

GOVERNMENT SUPPORT TO THE COTTON INDUSTRY

Subsidies to the cotton industry, including direct support to production, border protection, crop insurance subsidies, minimum support price mechanisms and export subsidies, are estimated at $1.3 billion in 2010/11 down from $3.2 billion in 2009/10 and $5.5 billion provided in 2008/09. Five countries provided subsidies in 2010/11, and the subsidies averaged 5 cents per pound, down from seven countries providing 11 cents per pound on average in 2009/10. More countries have cotton production support programs, but because of high prices the programs did not result in actual spending in 2010/11.

Record prices for cotton lead to a sharp decline in subsidies paid to producers during 2010/11. The Cotlook A Index averaged 61 cents per pound during 2008/09, 78 cents per pound in 2009/10 and 164 cents per pound in 2010/11. As a consequence, government interventions in a number of support programs in several countries were not triggered this season. Pakistan, Mexico and India have minimum support price programs, but because market prices were higher in 2010/11, these programs did not result in payments to producers. However, if prices were lower these programs would be effective.

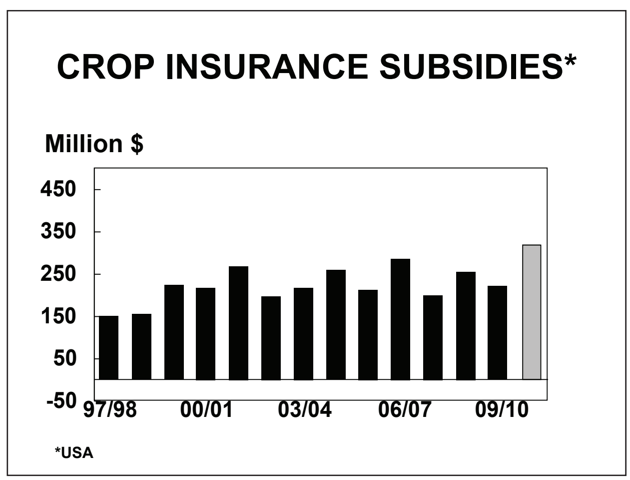


The share of world cotton production receiving direct government assistance, including direct payments and border protection, increased from an average of 55% between 1997/98 and 2007/08, to an estimated 84% in 2008/09. During 2009/10 the share declined to 52%, and is estimated at 53% of production in 2010/11. Since 1997/98, there is clearly a negative correlation between the Cotlook A Index and the amount of subsidy provided to the world cotton industry, as well as the number of subsidizing countries.

Some countries provided subsidies for cotton inputs in 2010/11, especially for fertilizers, storage, transportation, classing services and other marketing costs.

United States

The U.S. cotton program supports producers through several mechanisms: a direct payment (DP), a counter-cyclical payment (CCP), a loan deficiency payment (LDP), certificate exchange gains, marketing loan gains and crop insurance.



The DP, which is independent of market prices and is based on historical planted area and yields, is set at 6.67 cents per pound. The DP (income aid) is decoupled from the current production and is not counted as a subsidy to production[1]. It is estimated that in 2010/11 the DP were $588 million, unchanged from 2009/10.

Except for crop insurance, other subsidies under the U.S. cotton program were not available because of record market prices in 2010/11.

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1) In previous reports the Secretariat incorrectly included the DP into total subsidies provided to cotton production. The DP is not tied to current production or market prices and will not be counted as direct subsidies from now on. The Secretariat estimates of annual subsidies are adjusted backward to account for this change.

The CCP, which is also based on historical planted area and yield, is paid when the effective price is below the target price (71.25 cents per pound or 1.15 cents lower than under the previous farm bill)[2]. The CCP is paid whether a producer plants cotton, or not. The CCP was available to eligible farmers for a short period during the first half of 2009/10, and was estimated at $152 million. The CCP was zero in 2010/11.

The LDP is paid when market prices (the adjusted world price or AWP) are below the loan rate (52 cents per pound). The AWP stayed above the loan rate during both 2009/10 and 2010/11, resulting in zero LDP. 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 for the producer. The certificate exchange gains were estimated at zero both in 2009/10 and in 2010/11. While marketing loan gains were estimated at $6 million in 2009/10 and are estimated at zero in 2010/11.

The level of direct government assistance provided through export programs was estimated at $8 million in 2009/10 paid under the U.S. Pima competitiveness program. During 2010/11, no payments under the U.S. Pima competitiveness program were made.

Another form of government support to cotton production in the USA is provided through subsidized crop insurance to protect producers against losses to crop yields caused by natural disasters. Nearly every cause of decline in crop yields is covered by this multi-peril crop insurance, such as weather, pests, and fire, but not producer negligence. The insurance is sold to farmers, largely through private insurance providers, but USDA's Risk Management Agency (RMA) pays more than half of the premiums. Additionally, the RMA pays the private insurance providers for their administrative and operating costs, plus the RMA's own administrative costs under the program. On average, more than 90% of planted cotton acreage is enrolled in the program.

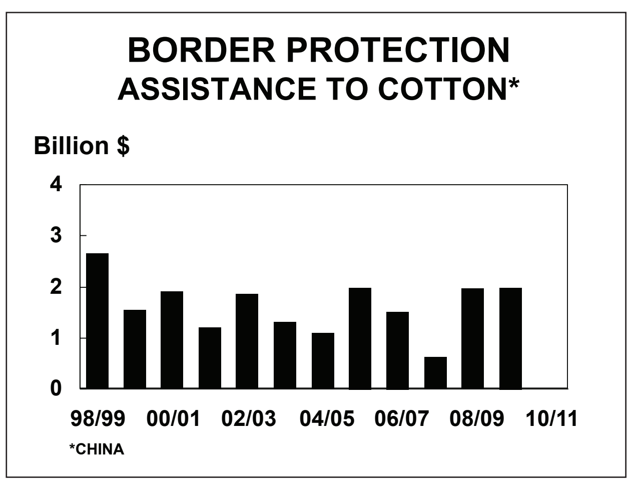
The crop insurance program is statutorily mandated to be actuarially sound, meaning that over time total premiums are supposed to cover total indemnities. During the past 14 years, the premiums exceeded indemnities in 1997, 2004, 2005, 2007 and 2010. Underwriting gains and losses are allocated between the companies and government according to formulas contained in the reinsurance agreement between the parties.

Total premium subsidies averaged $219 million per year between 1997 and 2009. Total crop subsidies fluctuated from 1.7 cent per pound of total production (1997) to 4.1 cents per pound (2008) during the past 14 years. In 2010/11 total crop insurance subsidies are estimated at $319 million ($220 million in 2009/10), or 3.7 cents per pound of total production.

Total U.S. support to cotton production, including crop insurance subsidies, declined from $451 million in 2009/10 to an estimated $319 million in 2010/11. Support in 2009/10 was equivalent to 8 cents per pound of production and declined to an estimated 4 cent per pound during 2010/11.

China

During the past several seasons, government policies in China supported cotton production by exercising border protection based on sliding scale duties or direct purchases by the government for reserves. As a result of government interventions and quotas, domestic cotton prices in China were above international prices.



Under the terms of its accession agreement into 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 require-

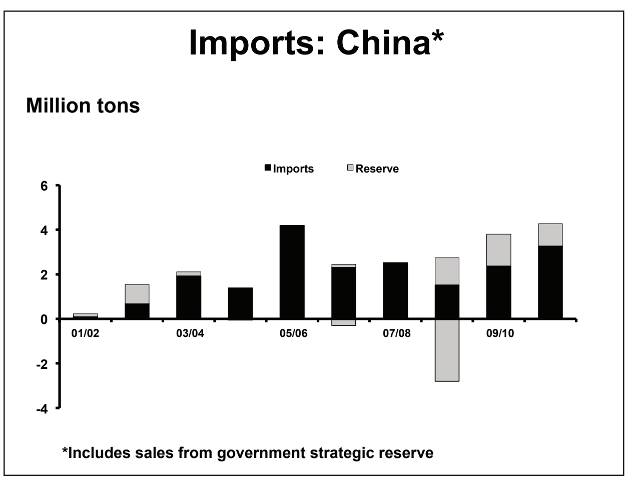
2) The effective price is the DP plus the higher of the national average market price paid to producers or the loan rate.

ments. 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.

China did not use sliding-scale cotton import quotas during the world recession in 2008/09. Instead, the government bought about one-third of domestic cotton production that season, 2.724 million tons, for the government reserve. The China National Cotton Reserves Corporation (CNCRC) is the agency that manages the state reserve.

In 2009/10, the sliding-scale import quotas were used, providing support to domestic prices. The Secretariat uses the difference between domestic and imported cotton prices as an estimate of the support to Chinese cotton prices that results 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 the value added tax, port charges and transportation to mills, averaged 11 US cents per pound in 2009/10, (10 cents per pound in 2008/09). The estimate of benefits resulting from government intervention in China received by producers in 2008/09 was about US$1.6 billion and $1.7 billion in 2009/10.

In 2010/11 (the season ended on July 31, 2011), the tariff-rate-quota (TRQ) of 1% for 894,000 tons was released for calendar year 2011, as usual. In calendar 2010 2.7 million tons of import quotas under the sliding scale duty system were released. In addition, sliding scale duty quotas for 1.7 million tons were announced for calendar 2011. This quota beyond the TRQ in 2011 will operate under the same sliding-scale duty system in force during 2010, namely at a rate ranging from 5% to 40% of CIF values for imports costing less that 11,397 Yuan per ton, or 80 cents per pound at the exchange rate of 6.46 Yuan per U.S. dollar as of July 1, 2011. There is a fixed rate duty of 570 Yuan per ton (4 cents per pound) for imported cotton priced above 11,397 Yuan per ton. International cotton prices averaged 164 cents per pound during 2010/11. As a result, duties on imported cotton this season are fixed at 570 Yuan per ton, representing about 2% of import costs. Domestic cotton prices in China stayed below international levels beginning in mid-December, 2010. Because world cotton prices were record high in 2010/11, the border protection measures used by China had no measureable impact on domestic cotton prices.



In addition, the government of China pays growers a subsidy for using high-quality planting seeds, about $180 million a year. During the past two seasons China provided subsidies for transportation of cotton from Xinjiang to mills in east and south China estimated at about $150 million per year.

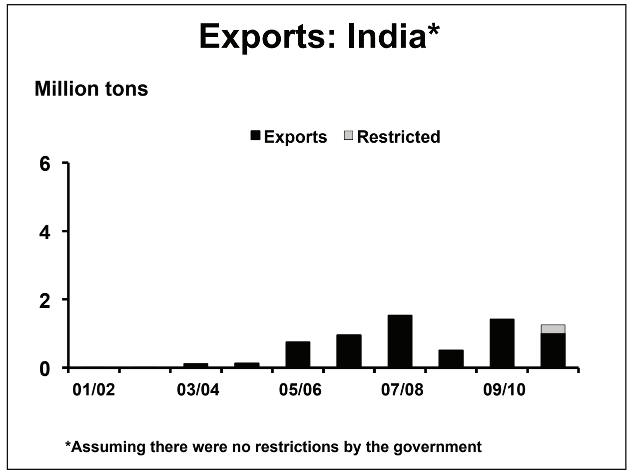
All three types of subsidies totaled an estimated $2 billion in 2009/10 and $327 million in 2010/11.

The Ministry of Finance (MOF) in China paid about $290 million during the first half of 2011 to pay for the interest on loans that were given for agricultural projects benefiting cotton, grain and vegetable oil processing.

China maintains significant strategic reserves of cotton. China releases cotton to the market through a system of auctions when there is a shortage, the government replenishes the reserves when there is an abundance of supplies and prices are reasonably low. During the past decade, the largest sales of government reserves were made in 2009/10 (1.4 million tons) and in 2010/11 (1 million tons). The largest purchases for the state reserve of 2.8 million tons were made in 2008/09. Release of the reserves to domestic mills reduces the need for imports and limits growth in world trade, while purchases for the reserve boost domestic prices in China and increase world trade.

India

In 2010/11, the Indian government restricted exports of cotton to about 1.1 million tons. Without the restriction, net-exports from India could have grown to about 1.25 million tons, and India could have both exported and imported cotton in 2010/11. Assuming exports from India could grow to 1.25 million tons in 2010/11 in the absence of export restrictions, ending stocks in India would be falling to 17%. If realized, this would be a very low level compared with the average stocks to use ratio of 33% maintained since 1990/91.

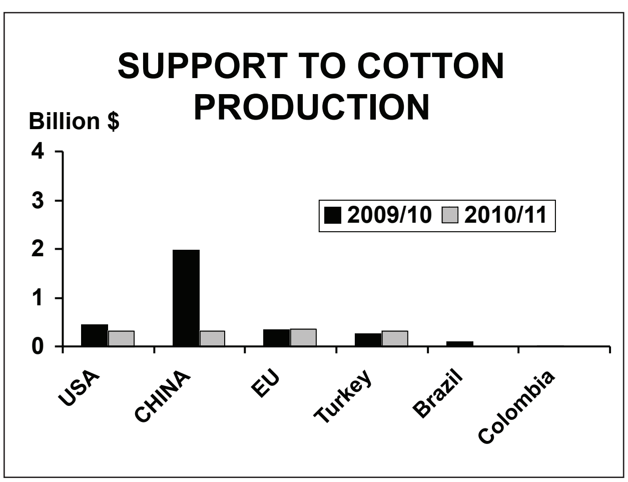


India has a Minimum Support Price program, but because market prices were high in 2010/11, this program did not result in payments to producers.

Cotton farmers in India benefit from debt forgiveness and fertilizer subsidies from the government of India. In addition the Government of India provides support to cotton production through several programs, such as development of infrastructure facilities for production and distribution of quality seeds. Under the government's Technology Mission, support was provided for modernization of ginning and pressing units and for improving cotton marketing during the past several years. These benefits are difficult to quantify, and some are not specific to cotton. 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 (CAP) starting in 2009/10. As before, cotton producers receive 65% of EU support as a single decoupled payment (income aid) and the remaining 35% as an area payment (coupled, or production aid). Greece and Spain are major cotton producers in the EU. For production aid the maximum base eligible areas were reduced and are now set at 250,000 hectares for Greece and 48,000 hectares for Spain. To be eligible for the 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 per hectare for Greece and at 3.5 tons per hectare for Spain. The fixed amounts per hectare are fixed at euro 251.75 for Greece and euro 400 for Spain. If the eligible area exceeds the maximum base area, the aid per hectare is reduced proportionally.



It is estimated that in 2010/11 the amount of direct subsidy to production in Greece was $276 million ($260 million in 2009/10) resulting in 70 US cents per pound of lint production (55 U.S. cents in 2009/10). The subsidy in Spain is estimated at $92 million ($93 million in 2009/10), or 93 US cents per pound of lint (196 U.S. cents in 2009/10).

Turkey

The government of Turkey pays a premium per kilogram of seed cotton to producers (the premium is higher for seed cotton produced from certified seeds). The premiums for 2010/11 were not changed from 2009/10 and are 0.42TRL/kg for seed cotton produced from certified seeds (26 US cents per kg) and 0.32TRL/kg for seed cotton produced from regular seeds (21 US cents per kg). 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 rose from $260 million in 2009/10, to $309 million paid in 2010/11 as a result of increased planting.

Brazil

Brazil continues a marketing program providing direct subsidies to producers based on guaranteed prices, but without direct acquisition of cotton by the government. The program is called the Equalizer Price Paid to the Producer (PEPRO – Prêmio Equalizador Pago ao Produtor). The PEPRO is used to compensate farmers for the weakening US dollar in relation to the Brazilian real. The premium paid under the program represents the difference between the minimum-guaranteed price and the price the buyer is willing to pay. The minimum-guaranteed price is set at R$ (Brazilian real) 44.60 per arroba (15 kg) of lint, or an equivalent of 86 cents per pound at the exchange rate prevailing at the beginning of May 2011. The actual size of the premium is determined at auctions organized by the government. In 2009/10, payments under the PEPRO were $99 million (4 cents per pound). There were no auctions during 2010/11.

The government of Brazil also provides support to cotton production through subsidized credit for production, marketing and investments. It is estimated that subsidized annual credit to cotton producers averaged around half a billion U.S. dollars during the past decade. Low-income cotton growers receive subsidized interest rate of 5%, compared with market rates of 20-25%. Base on the difference, it is estimated that the maximum annual subsidy received by cotton growers in a form of subsidized interest averaged $75 million during the past decade.

Colombia

In Colombia, direct government payments to producers in 2010/11 are estimated at $9 million, averaging 11 cents per pound. In 2009/10 direct government payments were estimated at $22 million averaging 37 cents per pound.

Registration of Cotton Exporters by the Government of China

The General Administration of Quality Supervision Inspection & Quarantine (AQSIQ) of China established a requirement for a registration process for foreign cotton suppliers effective March 15, 2009. The major concerns are that the system unfairly subjects suppliers to different levels of inspection and oversight, potentially based on a single infraction, and the registrations may damage the reputation of foreign suppliers through the publication of downgraded ratings. The potential disruption in trade from this system could be compounded by quality assessment methods for imported cotton diverging from those used internationally or used by China for domestic cotton.

Ten lists of registered companies have been published by AQSIQ. As of the beginning of July 2011, 338 companies were registered with the AQSIQ. The list of registered companies includes major and small cotton firms from North America, South America, Asia, Africa, Europe and Australia, from all major exporting countries, including government owned firms, private and cooperative organizations.

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

	2009/10			2010/11 **		
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
China	6,925	11	1,981	6,400	2	329
USA	2,654	8	451	3,942	4	319
Greece	215	55	260	180	70	276
Turkey	380	31	260	450	31	306
Brazil	1,194	4	99	2,052	0	0
Spain	22	196	93	43	97	92
Colombia	27	37	22	35	11	9
All Countries	11,417	11	3,166	13,101	5	1,330

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

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

	2009/10			2010/11 **		
Country	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	2,621	0	27	3,244	0	0
Upland cotton	2,470	0	0	3,142	0	0
Pima	151	8	27	102	0	0
Total	151	8	27	102	0	0

** Preliminary.