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BACKGROUND NOTE – 6 June 2006

Cotton Supply and Government Measures: A rather straight-forward relationship

On May 22, the International Cotton Advisory Committee (ICAC) reported on the recent World Cotton Situation. The issues reported make interesting reading in the context of the ongoing Doha Development Agenda negotiations. We would like therefore to share the information with our readers and comment on its link to the negotiations.

Supply & Demand Situation

The ICAC secretariat reported that *production is expected to remain above the long-term trend because of good weather and the adoption of new technologies. Despite lower market prices, world cotton area remains near record high, perhaps because better yields are maintaining farmers' incomes. Of course, higher yields themselves are contributing to increases in production.*

Further, the secretariat reported that *world cotton consumption continues to rise, and that growth of 6% is expected during the current season. However, the rate of increase in world consumption would likely slow in 2006/07. World trade in cotton is rising to a record level because of increased imports by China (Mainland)*.

Government Measures Affecting Cotton

ICAC Secretariat's Preliminary Report summarizes government measures affecting cotton production and trade as follows: " *… eight countries offered direct income and price support in 2004/05 totalling $4.7 billion, and seven countries are providing direct support to cotton production in 2005/06 amounting to an estimated $5 billion. In 2005/06, support includes about $2 billion each in China (Mainland) and the USA, about $900 million in the EU, $69 million in Turkey, $21 million in Colombia and $17 million in Mexico. In addition, he noted that the USA is providing about $200 million for cotton export assistance in 2005/06, including $11 million for Pima cotton and the balance for Upland cotton.*"

In response to specific questions raised, the Secretariat reported as follows:
"… *In 2005/06, the U.S. is providing an estimated $186 million in support of Upland cotton exports through the program known as Step 2, and the U.S. has committed to*

elimination of this program on August 1, 2006. In 2005/06, the U.S. is providing an additional $11 million in assistance to exports of Pima cotton, and this program will continue next season. It was explained that the case brought by the Government of Brazil against the U.S. cotton program in the WTO was based on Upland cotton. Therefore, under the terms of the dispute panel decision, the U.S. is obligated to change certain portions of its Upland cotton program.

In response to further questions, the delegate of the USA stated *that he could not speculate on the sentiments of growers and others in the cotton industry about potential changes in future U.S. farm legislation. He noted that stakeholders in the U.S. were engaged in discussions of U.S. farm policy, and that any changes in the cotton program were likely to occur within the context of changes to the total farm bill*.

…

The Brazilian delegate noted *that under commitments made during the Uruguay Round of GATT negotiations, the U.S. is obligated to modify its Upland cotton program. He said that the pending elimination of Step 2 by August 1, 2006 was a positive step, but that the decision in the cotton case brought by Brazil includes broader ramifications. He said that Brazil looks forward to full implementation of the panel decision.*

The delegate of the USA replied that *his country is committed to full compliance with the WTO cotton case, and that the U.S. government has already taken steps to modify the GSM program, which provides export credit guarantees, and to elimination of the Step 2 program. He said that the U.S. is committed to a successful outcome to the Doha Development Round, with commitments on cotton being agreed as part of an overall outcome on agriculture. He said that the U.S. is fully involved in the development aspects of the Doha Round. Progress has been made on the U.S. West African Cotton Improvement Program. He said that the U.S. has already committed $7 million to the program and was engaged in discussions on how to scale up assistance*.

Comments

Despite lower prices, farmers have been and are expected to continue increasing their production year after year, in spite of decreasing prices. Obviously, part of this growth is due to subsidies that shelter some of the producers from world market price signals (see below). But the data shows that cotton production increases also in countries that do not subsidize cotton production. This would indicate that longer-term trends of cotton prices are downwards and that farmers have to increase their productivity to maintain their incomes. This underlines the importance of investments into the cotton production and the need for assistance to the poor African countries. The report also emphasizes the importance of internal reforms in those countries, independently of the outcome of the Doha Negotiations.

It is good news that cotton producers have been and can expect to continue benefiting from better than average production conditions. That lower than forecasted world market prices represent the downside of this positive situation is indeed to be expected. However, the present level of cotton production should not only be attributed to climate and technology. The figures contained in the summary on Government Measures in cotton production speak a clear language. In the crop year 2005/06, seven countries spent about 5 billion in direct support to their cotton production. Four out of the five billions were spent by the two largest producers, Mainland China and USA, in approximately equal parts. In addition, the USA spent, in the same period, some 190 million US$ in support of cotton exports.

Common sense is enough to reach the conclusion that these investments stimulate a cotton production that would otherwise not take place at the same level. Production pattern, output quantities and price levels are therefore not only a result of production costs, climate, technology and market demand; they are as much influenced by subsidies – this to the detriment of producers in countries that do not and cannot afford to subsidise their production.

What makes things worse is the fact that most of this money, the 4 out of the 5 billions US$, is spent by the 2 economies that are considered among the most competitive in the world. With this money, the USA contributes to their dominance of the world cotton market, supplying in excess of 30% of quantities traded. Mainland China, in spite of being by far the largest cotton importer – thanks to the competitiveness of its textile industry – could offer to competitive cotton producers substantial additional market opportunities by scaling down the artificial stimulation of its domestic cotton production.

Last but not least, the statement of the delegate of USA as reflected above, in relation to the Panel and Appellate Body decisions on US Upland Cotton tells us in essence that:

- the USA are in principle committed to full compliance with the Panel's recommendations;
- compliance will depend on the outcome of the ongoing internal political discussion on the US Farm Bill;
- compliance is to be achieved within the conclusion of the Doha Round Agricultural negotiations.

We would like to remember that the Cotton Panel examined the compliance of certain USA cotton policies in respect of their compliance with the results of the Uruguay Round. The Doha round is supposed to lead to new commitments towards a market free of government intervention – not the implementation of already agreed upon obligations.

IDEAS Centre offers policy advice services to developing and transition country governments in the areas of international trade, development and economic governance. In relation to the World Trade Organization (WTO), IDEAS Centre helps low-income countries defend their trade interests and thus use their WTO membership in a way that supports their development.

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