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PRODUCTION AND TRADE POLICIES AFFECTING THE COTTON INDUSTRY

October 2016

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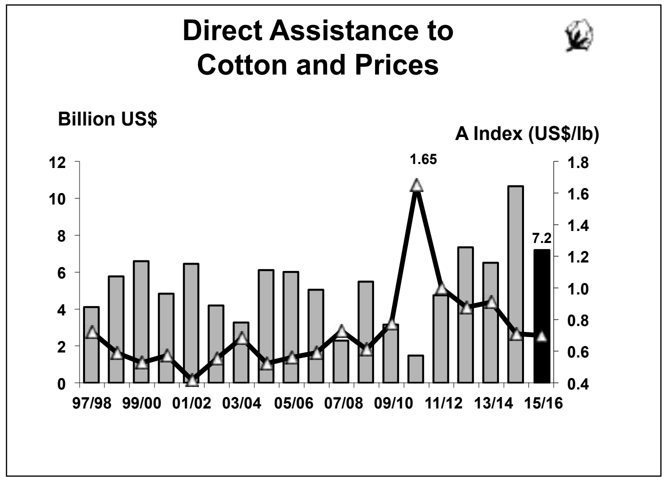
A report by the
Secretariat of the
International Cotton Advisory Committee

Washington DC, USA

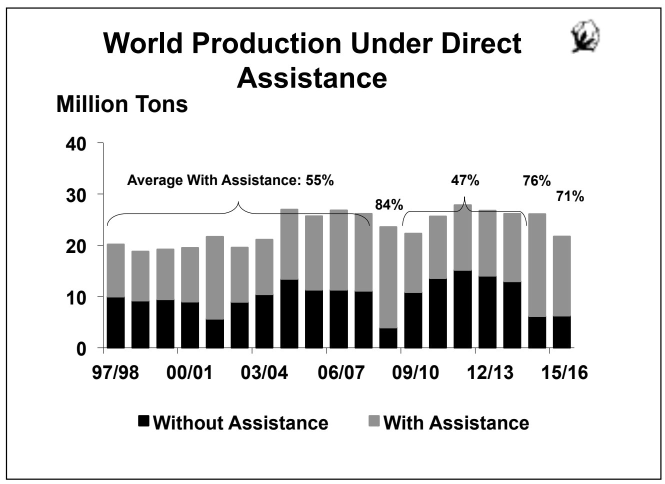
GOVERNMENT SUPPORT TO THE COTTON INDUSTRY

Subsidies to the cotton sector, including direct support to production, border protection, crop insurance subsidies, and minimum support price mechanisms are estimated at $7.2 billion in 2015/16, down 30% from a record of $10.7 billion in 2014/15. Eleven countries provided subsidies in 2015/16, and the subsidies averaged 18 cts/lb, down from 21 cts/lb in 2014/15.

Since 1997/98, when the Secretariat first began reporting on government support measures in cotton, there has been a strong negative correlation between subsidies and cotton prices: in years when prices are high, subsidies tend to decline and in years when prices are low, subsidies tend to rise. This relationship was maintained during the past several seasons. The Cotlook A Index declined from an average of 91 cts/lb in 2013/14 to an average close to 70 cts/lb in 2014/15 and 2015/16, and subsidies provided to cotton growers were at record levels.



In some countries, including Brazil, Pakistan and India, minimum support price programs were not triggered, or were only partially active (India) during 2015/16 because market prices were above the government intervention prices during most of the season. A number of countries implement border protection measures during some seasons and the Secretariat makes every effort to report on the effect of these measures when they are quantifiable.



Some countries continued to provide subsidies for cotton inputs in 2015/16, especially for fertilizers, storage, transportation, classing services and other marketing costs. At the same time, the use of crop insurance subsidies is increasing, although still not widespread.

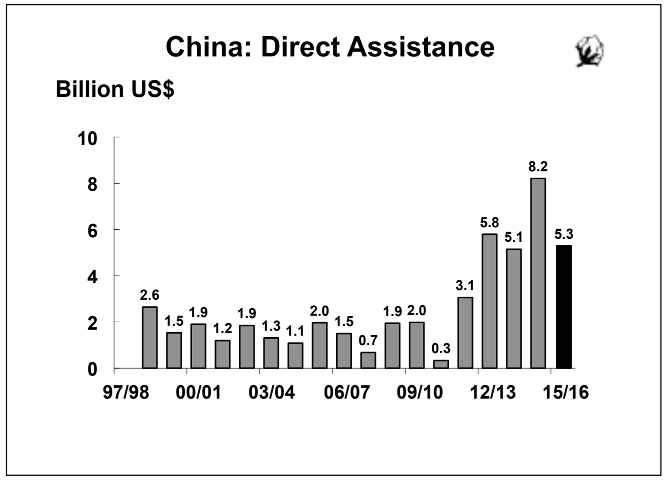
The share of world cotton production receiving direct government assistance, including direct payments and border protection, increased from an average of 55% between 1997/98 and 2007/08, to an estimated 83% in 2008/09. During 2009/10 through 2013/14, this share declined and averaged 48%. In 2014/15 the proportion of production receiving direct assistance increased to 76%. The share declined to 71% in 2015/16.

China

The Government of China supports cotton production by controlling cotton import volumes and values and by applying border protection measures based on quotas and sliding scale duties, with an effective tariff of 40% on cotton imported without a quota. In addition, China maintains a strategic reserve of cotton, serving as a national buffer stock, which is managed by the China National Cotton Reserve Corporation (CNCRC). China releases cotton to the market from the reserve through a system of auctions when there is a shortage, and replenishes the reserve in times of abundance, thus supporting prices.

There were no purchases for the government reserves during 2014/15 and 2015/16. Instead, the government paid direct subsidies to cotton growers, in addition to the border protection benefits enjoyed by producers in China.

Under the terms of its accession agreement to 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 requirements. 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. During 2014/15 and 2015/16, China restricted imports by issuing only the TRQ import quotas, with the objective of reducing government socks. As a result of government interventions and quotas, domestic cotton prices in China have exceeded international prices during these two seasons.



The Secretariat uses the difference between domestic and imported cotton prices as an estimate of the border protection support to Chinese cotton resulting 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 value added tax, port charges and transportation to mills, is used in calculations. The benefit (subsidy) received by producers in China as a result of the government border protection is estimated at $1.1 billion in 2015/16, or 10 cts/lb, down sharply from $3.2 billion, or 22 cts/lb, in 2014/15.

In addition, during 2014/15 and 2015/16 the Chinese government provided direct subsidy payments to cotton producers in Xinjiang based on the difference between a set season target price and an average market price. For 2014/15, the target price was set at 19,800 yuan/ton (about 147 cts/lb at the average seasonal exchange rate). The target price was reduced to 19,100 yuan/ton (about 134 cts/lb at the average seasonal exchange rate) for 2015/16. Using the difference between the target price and the average CC index (domestic cotton price), it is estimated that direct subsidies paid to producers in Xinjiang totaled $3.5 billion, or 45 cts/lb in 2015/16, down from $4.1 billion, or 41 cts/lb in 2014/15. In other provinces a direct subsidy of 2000 yuan/ton was provided to producers during both seasons. It is estimated that these direct subsidies totaled $410 million, or 14 cts/lb in 2015/16 down from $670 million or 15 cts/lb in 2014/15. Total direct subsidy payments provided to producers in China in addition to border protection support are estimated at $3.9 billion in 2015/16, down from $4.7 billion in 2014/15. The decline is attributed to a reduction in cotton production during 2015/16.

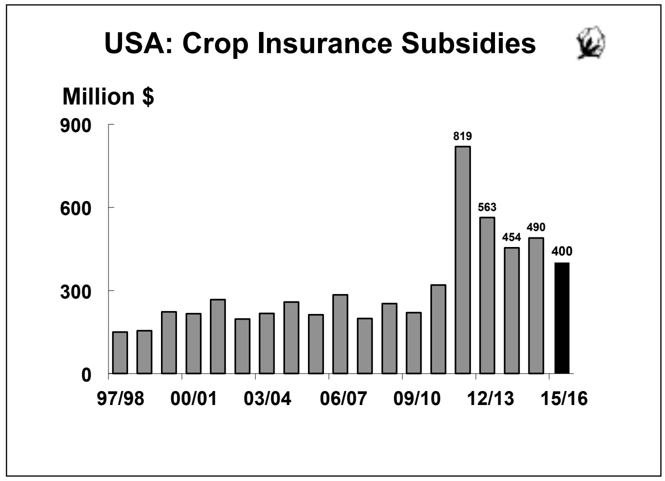
In addition, the government of China pays growers a subsidy for using high-quality planting seeds, amounting to about $150 million a year, although smallholder farmers do not benefit significantly from this policy. During the past several seasons, China provided subsidies for transportation of cotton from Xinjiang to mills in eastern and southern China, which are estimated at about $160 million per year.

All types of subsidies provided by the Chinese government are estimated at $5.3 billion in 2015/16 or 50 cts/lb, down from $8.2 billion in 2014/15 (57 cts/lb).

United States

On February 7, 2014, President Obama signed the 2014 U.S. Farm Bill into law. The new five-year farm bill marks a significant change in farm policies, to an environment in which guaranteed payments no longer exist and eligibility for payments will be based on declining prices, crop failures or reductions in revenue. The new Farm Bill marks an evolution from traditional farm income support programs to a focus on production and price risk management, with government-subsidized crop insurance as the primary instrument. Direct Payments, Countercyclical Payments and Average Crop Revenue Election (ACRE) programs have been repealed for all commodities. Upland cotton is not eligible for other commodity risk management programs established under the bill but becomes eligible for a new and unique “safety net” program, the Stacked Income Protection Plan (STAX).

STAX provides upland cotton producers with premium subsidies on the purchase of insurance policies that cover “shallow” revenue losses--those below the level generally covered by standard crop insurance policies. Producers may use this program alone or in combination with existing underlying crop insurance. Under STAX, a payment is triggered if the actual income in a county falls below 90% of the expected income. STAX provides coverage for revenue shortfalls between 10 and 30% of expected income and producers may select coverage in 5% increments. The federal government subsidizes about 80% of the premium. In addition, the federal government partially subsidizes the administrative and operational costs of the insurance companies offering STAX.



STAX came into effect during the 2015 growing season (starting in August 2015). During 2014/15 a cotton transition assistance payment was provided through the Farm Service Agency, which was calculated using a formula involving marketing year average prices for upland cotton, the national program yield of 597 pounds per acre and 60% of the cotton base acres[1] for the farm in 2014 and 36.5% of the base acres in 2015. It is estimated that transitional payments during 2014/15 totaled $484 million. Total subsidies provided under STAX in 2015/16 are estimated at $76 million. It is estimated that 950,000 hectares were insured with STAX, or about 29% of harvested area in 2015/16. A significant share of STAX policies was purchased in combination with an underlying standard crop insurance.

The Marketing Loan Program (MLP) continues with a marketing loan rate based on the world cotton price, calculated as the simple average of the adjusted prevailing world price (AWP) for the two immediately preceding marketing years (announced October 1 preceding the next domestic plantings), but in no case lower than 45 cts/lb or higher than 52 cts/lb. The loan rate for extra-long staple (ELS) cotton is set at 79.77 cts/lb. Under the program, producers are eligible for a loan deficiency payment (LDP), certificate exchange gains or marketing loan gains (MLG). The LDP is paid when market prices (AWP) are below the loan rate. 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 to the producer. LDPs were estimated at $139 million in 2015/16, down from $173 million in 2014/15. Marketing Loan Gains were estimated at $188 million in 2015/16, up from $198 million in 2014/15.

In addition, the U.S. government provides support to cotton production through subsidized crop insurance to protect producers against losses to crop yields caused by natural disasters. This multi-peril crop insurance covers nearly every cause of declines in crop yields, such as weather, pests, and fire, with the exception of producer negligence. The insurance is largely sold to farmers through private insurance providers, although the Risk Management Agency (RMA) of the U.S. Department of Agriculture pays more than half of the premiums. On average, more than 90% of planted cotton acreage is enrolled in this program.

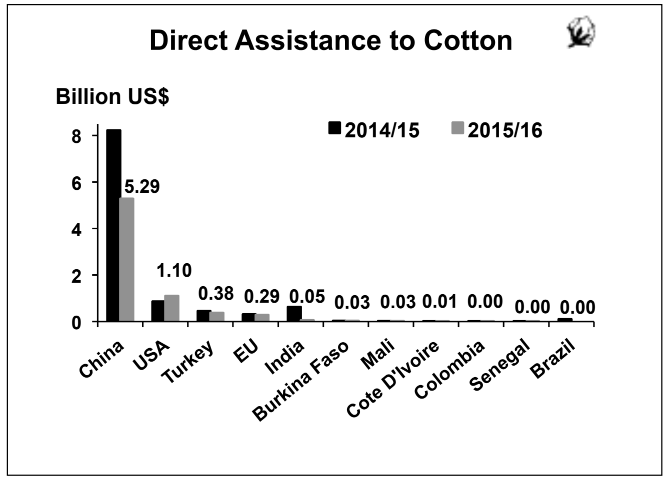
The crop insurance program is statutorily mandated to be actuarially sound, meaning that total premiums are supposed to cover total indemnities over time. Underwriting gains and losses are allocated between the companies and government according to formulas contained in the reinsurance agreement between the parties. During 2015/16, cotton insurance subsidies are estimated at $400 million, or 6.5 cts/lb, compared with $490 million, or 6 cts/lb in 2014/15.

In addition to described support, the USDA announced on June 6, 2015, that the USDA Farm Service Agency (FSA) will provide an authorized maximum $300 million in cost-share assistance payments to cotton producers through the new Cotton Ginning Cost-Share program in order to expand and maintain the domestic marketing of cotton. Through this program, eligible producers can receive a one-time cost-share payment, which is based on a producer’s 2015 acres reported to FSA, multiplied by 40% of the average ginning cost for each production region. Sign-up for the program

1) The term `generic base acres’ means the number of base acres for cotton in effect under section 1001 of the Food, Conservation, and Energy Act of 2008 (7 U.S.C. 8702), as adjusted pursuant to section 1101 of such Act (7 U.S.C. 8711), as in effect on September 30, 2013, subject to any adjustment or reduction under section 1112 of this Act. Source: http://www.gpo.gov/fdsys/pkg/BILLS-113hr2642enr/pdf/BILLS-113hr2642enr.pdf

began on June 20, 2016 through August 5, 2016, and payments were set to begin in July 2016. The program has the same eligibility requirements as were used for the 2014/15 Cotton Transition Assistance Program, including $40,000 per producer payment limit, requirement to be actively engaged in farming, compliance with conservation standards and a $900,000 adjusted gross income limit.

The sum of all types of support provided to U.S. cotton producers, including crop insurance, STAX, LDP, MLG and the Cotton Ginning Cost-Share program, is estimated at $1.1 billion or 18 cts/lb in 2015/16, compared with $860,000, or 11 cts/lb provided in 2014/15.



India

India has a Minimum Support Price (MSP) system which was operational during 2014/15 and 2015/16 through direct cotton purchases by the government because market prices were below the MSP during at least part of those seasons.

For 2014/15 the MSP for medium staple cotton (J-34) was set at Rs3,950 per 100 kg of seed cotton, equivalent to 85 cts/lb of lint at the season average exchange rate. Domestic prices in India stayed below the MSP during most of 2014/15. As a result, the Cotton Corporation of India (CCI), an agency of the central government, and state cotton organizations directly purchased an estimated 1.6 million tons of cotton, or a quarter of production, at MSP prices at an estimated cost of $2.9 billion. Average domestic spot prices in India for a representative variety were estimated at 66 cts/lb. Based on the difference between the procurement price and the value of the government stock at market prices, it is estimated that the cost of MSP operations to the Indian government reached $631 million, if cotton was sold at the average prices. This would represent a subsidy of 4 cts/lb if applied to total production.

The MSP for 2015/16 was increased to Rs4,000 per 100kg of seed cotton, equivalent to 80 cts/lb of lint, at the season average exchange rate. Domestic prices in India stayed below the MSP for a short period during the first half of the season and were estimated at 64 cts/lb, As a result, the CCI procured 144,000 tons at MSP prices at an estimated cost of $250 million. Based on the difference between the procurement price and the value of the government stock at market prices, it is estimated that the cost of MSP operations to the Indian government could reach $51 million.

Cotton farmers in India benefit from debt forgiveness and fertilizer subsidies from their government. India also provides some backing in the form of subsidies for crop insurance, although the value of this support is unknown. In addition, the Government of India provides support to cotton production through several programs, such as the development of infrastructure facilities for production and distribution of quality seeds. Under the government's Technology Mission, support was provided for the modernization of ginning and pressing units and the improvement of cotton marketing in recent 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.

In 2015/16 the amount of direct subsidy to production in India was estimated at $50 million or 0.4 cts/lb of lint production, compared with $631 million, or 4 cts/lb provided in 2014/15.

European Union

Changes were introduced in the EU Common Agricultural Policy starting in 2009/10. As before, cotton producers receive 65% of EU support in the form of a single decoupled payment (income aid) and the remaining 35% in the form of an area payment (coupled, or production aid). Greece and Spain are the major cotton producers in the EU. For production aid, the maximum base eligible areas are set at 250,000 hectares for Greece and 48,000 hectares for Spain. To be eligible for 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/hectare for Greece and at 3.5 tons/hectare for Spain. The amounts per hectare are fixed at 251.75 euros for Greece and 400 euros for Spain. If the eligible area exceeds the maximum base area, the aid per hectare is reduced proportionally.

In 2015/16 the amount of direct subsidy to production in Greece was estimated at $224 million ($238 million in 2014/15), equivalent to 47 cts/lb of lint production (39 cts/lb in 2014/15). The subsidy in Spain is estimated at $68 million in 2015/16 ($72 million in 2014/15), or 55 cts/lb of lint (44 cts/lb in 2014/15). The decline is a result of budgetary cuts and a stronger U.S. dollar in relation to the euro.

Turkey

The government of Turkey pays a premium per kilogram of seed cotton to producers. In the past the premium for seed cotton produced from certified seeds was higher than that from non-certified seeds. No premium has been paid for non-certified seed since 2012/13. The premium for 2015/16 was increased to 0.75 TRL/kg, from 0.65 TRL/kg in 2014/15, for seed cotton produced from certified seeds. 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 declined from $452 million in 2014/15, equivalent to 27 cts/lb of lint production, to $381 million in 2015/16 (26 cts/lb).

Brazil

Brazil operates a marketing program that provides direct subsidies to producers based on guaranteed prices, but without direct acquisition of cotton by the government. The program is called the Equalization Premium Paid to Producers (PEPRO – Prêmio Equalizador Pago ao Produtor). There were no PEPRO auctions in 2015/16.

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 $500 million during the past decade. Low-income cotton growers receive a subsidized interest rate of 5%, compared with market rates of 20-25%. Based on this difference, it is estimated that the maximum annual subsidy received by cotton growers in the form of subsidized interest averaged $75 million over the past decade.

Colombia

In Colombia, direct government payments to producers declined during the past two seasons. In 2014/15, direct assistance to cotton producers in Colombia was estimated at $5 million, averaging 9 cts/lb (down from 40 cts/lb in 2013/14). In 2015/16, direct government payments declined further to $3 million, averaging 5 cts/lb. Actual payments in Colombian pesos declined by 42% during 2015/16, but payments in U.S. dollar equivalent declined by 47% due to the depreciation of the domestic currency.

West Africa

Several countries in West Africa provided subsidies for cotton inputs in 2015/16 and 2014/15, especially for fertilizers and planting seeds. In 2015/16, Mali provided an estimated $26 million (5 cts/lb); Burkina Faso $30 million (5 cts/lb); Côte d’Ivoire $14 million (4 cts/lb); and Senegal $2 million (11 cts/lb).

Estimated Assistance Provided by Governments to the Cotton Sector*

Country	2014/15 Production	2014/15 Average Assistance per Pound Produced	2014/15 Assistance to Production	2015/16 ** Production	2015/16 ** Average Assistance per Pound Produced	2015/16 ** Assistance to Production
	1,000 tons	US cents	US$ Millions	1,000 tons	US cents	US$ Millions
China	6,500	57	8,220	4,820	50	5,289
USA	3,553	11	861	2,806	18	1,103
Turkey	754	27	452	660	26	381
Greece	273	39	238	218	47	224
Spain	75	44	72	56	55	68
India	6,460	4	631	5,749	0	51
Burkina Faso	298	5	30	244	6	30
Mali	233	5.1	26	216	5	26
Cote d'Ivoire	193	3	14	177	4	14
Colombia	27	9	5	22	6	3
Senegal	9	10	2	12	8	2
Brazil	1,563	3	102	1,348	0	0
All Countries	**19,937**	**21**	**10,653**	**14,980**	**18**	**7,191**

* Credit assistance not included. ** Preliminary.

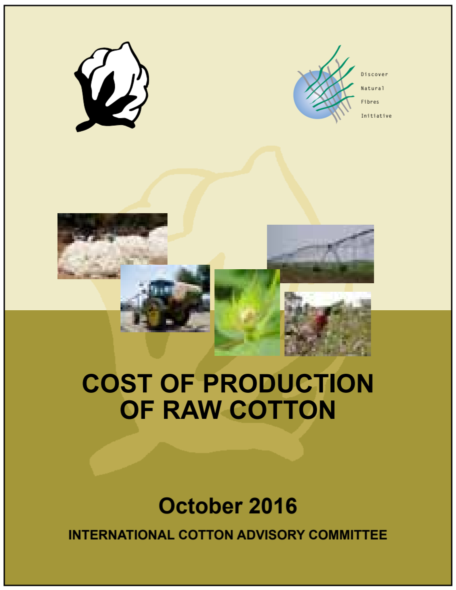
Estimated Assistance Provided by Governments to the Cotton Sector*

	World Production	Average Assistance per Pound Produced	Assistance to Production
	1,000 tons	US cents	US$ Millions
1997/98	20,181	9	4,108
1998/99	18,810	14	5,772
1999/00	19,194	16	6,588
2000/01	19,527	11	4,833
2001/02	21,668	13	6,446
2002/03	19,573	12	4,193
2003/04	21,131	7	3,270
2004/05	26,998	10	6,114
2005/06	25,688	11	6,008
2006/07	26,844	9	5,045
2007/08	26,160	4	2,292
2008/09	23,574	11	5,492
2009/10	22,292	6	3,155
2010/11	25,657	3	1,477
2011/12	27,848	8	4,866
2012/13	26,785	12	7,351
2013/14	26,199	11	6,513
2014/15	26,118	19	10,653
2015/16**	21,222	15	7,191

* Credit assistance not included. ** Preliminary.

COST OF PRODUCTION OF RAW COTTON

THE 2016 EDITION WILL BE AVAILABLE SOON



The report includes data by country for the 2015/16 season. Many countries are reporting data by region or type of cotton. This study is the only source of comparative information on the cost of cotton production in the world.

The costs of all field operations starting from pre-sowing to harvesting and ginning and economic and fixed costs have been determined and computed to determine the cost of production of cotton per hectare and per kilogram.

This report also includes a glossary in French and Spanish.

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