INTERNATIONAL COTTON ADVISORY COMMITTEE

Discover natural fibres 2009

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Government Support to the Cotton Industry
(Revised)

Direct government subsidies currently provided by eight countries through production programs is estimated to have decreased from US$3.7 billion in 2006/07, to less than US$1.8 billion in 2007/08. The Cotlook A Index averaged 72 cents per pound during the first nine months of 2007/08, or 13 cents higher than in 2006/07. As a consequence, support provided to the cotton sector declined in some countries. The Secretariat has reported on government subsidies to the cotton industry since 1997/98. The highest level of direct government assistance provided to the cotton sector by nine countries through production programs reached US$6.2 billion in 2004/05, when the Cotlook A Index averaged 52 cents per pound and a record crop of 26.7 million tons was produced. 14 countries provided US$5.8 billion in direct assistance to production in 2001/02, when the Cotlook A Index averaged a historically low 42 cents per pound. As a result of increased international prices, the estimate of government support to cotton production resulting from border protection policies decreased from $1.5 billion in 2006/07 to $680 million in 2007/08. The share of world cotton production receiving direct government assistance, including direct subsidies and border protection, increased from an average of 54% estimated between 1997/98 and 2004/05, to an estimated 57% in 2007/08. Since 1997/98, there is clearly a negative correlation between the Cotlook A Index and the amount of world cotton subsidy provided to the industry, as well as the number of subsidizing countries.

The level of direct government assistance provided through export programs is estimated to have decreased from $400 million in 2005/06 to $11 million in 2006/07 and is expected to increase to $44 million in 2007/08. During the past two seasons, only the U.S. Pima competitiveness program remains in effect.

USA

The 2002 farm bill in the USA channels direct support to cotton production through five mechanisms: a direct payment (DP), a counter-cyclical payment (CCP), a loan deficiency payment (LDP), certificate exchange gains and marketing loan gains.

DP, which are independent of market prices and based on historical planted area and yield, are set at 6.67 cents per pound. The DP increased in 2007/08 to $615 million (+$161 million).

CCP, which are also based on historical planted area and yield, are paid when the effective price is below the target price. The target price is set at 72.4 cents per pound. The effective price is the DP plus the higher of the national average market price paid to producers or the loan rate. The loan rate is set at 52 cents per pound. The CCP declined in 2007/08 to $416 million (-$865 million).

The LDP is paid when market prices are below the loan rate. The LDP declined to zero in 2007/08 (-$106 million).

In addition, producers are able to buy commodity certificates at the rate of the adjusted world price (AWP) and exchange them on the same day for cotton pledged as collateral to the Commodity Credit Corporation (CCC) for a commodity loan. Realized gains from the certificate exchange, called certificate exchange gains, equal the amount by which the loan rate exceeds the AWP. Certificate exchange gains are similar to LDP. Certificate exchange gains declined to zero in 2007/08 (-$1 billion).

Producers also may receive gains called marketing loan gains if the loan repayment rate is less than the loan principal, also called loan write-offs. Marketing loan gains also fell to zero in 2007/08 (-$7 million).

Total direct U.S. support to cotton production is declining from $2.9 billion in 2006/07 to an estimated $1 billion in 2007/08. During the past 10 years the highest U.S. direct support to cotton production of $3.9 billion was provided in 2004/05, an equivalent of 35 cents per pound. Average direct assistance to production declined to 28 cents per pound in 2006/07 and to 11 cents per pound in 2007/08.

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 declines in crop yield is covered by this multi-peril crop insurance, such as weather, pests, fire, but not producer negligence. While the insurance is sold to farmers, largely through private insurance providers, the USDA's Risk Management Agency (RMA) pays in excess of 50% of the premiums. Additionally, for 2006 the RMA payed the private insurance providers nearly 21% of total premiums toward their administrative and operative costs, plus RMA's own administrative costs, less than 2% of total premiums. On average, more than 90% of planted cotton acreage is enrolled in the program. This form of production support was not included in previous ICAC reports.

By design, the crop insurance program is supposed to be actuarially sound, meaning that over time total premiums are supposed to cover total indemnities. In practice, however, during the past 10 years, the premiums exceeded indemnities only in 1997, 2004, 2005 and 2007. The net losses (indemnities over premiums) fall upon the government, because it reinsures the privately marketed policies. The net losses are added to the premium subsidies to calculate a total cost of crop insurance to the government.

Total premium and indemnity subsidies averaged $234 million per year between 1997 and 2007, with the highest cost of $482 million paid in 2001. The government received $9 million in 2005 when the unsubsidized part of premiums exceeded premium subsidies and indemnities. Total crop subsidies fluctuated from 0.5 cent per pound of total production to 5 cents per pound during the past 10 years. In 2007/08 total crop insurance subsidies are estimated at $40 million or 0.4 cents per pound of total production.

European Union

Up until 2005/06, payments under the EU Common Agricultural Policy (CAP) were based on estimated seed cotton production for a maximum of 782,000 tons in Greece and 249,000 tons in Spain. Payments had a combined CAP floor payment of €770 million.

Changes in EU CAP policies were made effective January 1, 2006 and applicable to the 2006/07 and 2007/08 crop years. Under this new program, EU 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). The total budget allocated for these payments is around €770 million, the same as under the previous regime. The 35% coupled payment is given for a maximum area of 370,000 hectares in Greece and 70,000 hectares in Spain and is proportionately reduced if claims exceed the maximum area allocated to each country. To receive coupled area payments, producers must plant cotton and grow the crop until the stage of boll opening in normal agricultural conditions, but they are not forced to harvest the cotton. The amount of coupled support that resulted in actual cotton production in 2007/08 is estimated at $354 million (+$35 million), and most of the increase is caused by the depreciation of the U.S. dollar. The amount of direct subsidy per pound of cotton in 2007/08 increased from 33 to 40 U.S. cents per pound for Greek cotton and from 85 to 102 U.S. cents per pound for Spanish cotton. The higher direct subsidy per pound of cotton in Spain is due to significantly lower-than-average yields.

China (Mainland)

Policies enacted in 1999 introduced market forces to the cotton sector in China (Mainland). However, as a result of import quotas, domestic cotton prices in China (Mainland) were above international prices in recent seasons. The Secretariat uses the difference between domestic and imported cotton prices as an estimate of the support to Chinese domestic cotton prices which results from border protection.

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, decreased from 9 U.S. cents per pound in 2006/07 to 4 U.S. cents in 2007/08. As a result of increased international prices, the estimate of benefits resulting from border policies decreased from $1.5 billion in 2006/07 to $680 million in 2007/08.

In addition, 500 million Yuan, an equivalent of about $70 million, was paid by the central government of China (Mainland) in 2007/08 to growers as a subsidy for using high-quality planting seeds.

Other Countries

There are two types of income support programs for producers utilized by the government of Brazil. The first type of program is based on government purchases with guaranteed prices. The second type is oriented at marketing through direct subsidies paid to producers based on guaranteed prices, but without direct acquisition of cotton by the government. The second type of program was implemented in 2006, gained popularity among market participants and continued in 2007. The program actively implemented during 2006 and 2007 is called the Equalizer Price Paid to the Producer (PEPRO – Premio de Equalizer Pago ao Produtor). In essence 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 Reais) 44.60 per arroba (15 kg) of lint or an equivalent of 80 cents per pound at the current exchange rate. The PEPRO is used to compensate the farmers for the weakening U.S. dollar in relation to the Reais. The actual size of the premium is determined at auctions organized by the government, where a large number of participants in practice bid for the premium. The government's view is that a very competitive auction tends to lead to a lower level of subsidies paid to producers. A total of R$209 million, or US $95 million, was paid to producers under the program during 2005/06, or the equivalent of 4 U.S. cents per pound. In 2006/07, the payments under the program reached R$587 million, or US $290 million or the equivalent of 9 U.S. cents per pound. A first PEPRO auction in 2007/08 was held on May 15, 2008. As a result of the auction R$183, or an equivalent of US $110 million of subsidies were paid.

In Turkey, a higher premium for lint coming from certified seeds resulted in estimated total government payments of $183 million in 2007/08 compared with $196 million paid in 2006/07.

In Mexico, a support price mechanism with a target price of 64 U.S. cents per pound resulted in payments of $38 million in 2006/07, but declined to an estimated $8 million in 2007/08, as a result of higher market prices.

In Colombia, direct government payments to producers in 2007/08 are estimated at $10 million, averaging 10 cents per pound, half of what was paid in 2006/07.

The government of India announced an intention to write off debts in the amount of Rs 720 billion, or U.S. $18 billion owed by farmers to banks and cooperative banks. The loans will be waved as of end-March 2008 fully for farmers who have less than 2 acres. Farmers who have more than 2 acres will be offered 25% subsidy to settle their debts. Most cotton farmers in India cultivate between 3 and 20 acres so the number of cotton farmers who could receive complete waiver is expected to be negligible. The Indian Cotton Association of India is trying to access benefits to cotton farmers from this program through sample surveys.