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# Cotton provisions in the United States of America 2014 Farm Bill

# United States-Brazil cotton settlement and the post-Bali agenda for cotton producer developing countries

By

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# Cotton provisions in the US 2014 Farm Bill, US-Brazil cotton settlement and other major developments in the world cotton market

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There is a very strong historical correlation between cotton prices prevailing during the current season and planted area for the next season. A 25% decline in cotton prices during 2014/15, could lead to a decline in world cotton area in 2015/16 by 7% to 31.3 million hectares. The smaller area could result in a similar decline in world production, which is projected at 24 million tons in 2015/16, the lowest in 6 seasons. The largest declines in production in 2015/16 are projected for China, India, USA and Pakistan. These four countries are projected to reduce production by a cumulative 11% and will account for more than 70% of world production. Cotton production in Brazil and Uzbekistan is not projected to decline substantially. For the second consecutive season, India will remain the largest cotton producer. For the first time in six seasons world production in 2015/16 is projected below mill use.

Since 1997/98, when the ICAC Secretariat first began reporting on government 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.

The share of world cotton production receiving direct government assistance, including direct support to production, border protection, crop insurance subsidies, and minimum support price mechanisms, averaged about 55% between 1997/98 and 2013/14. There was a spike in government interventions in 2008/09, when the share of subsidized production jumped to 84%. Ten countries provided subsidies in 2013/14, and the subsidies averaged 26 cents per pound.

The largest subsidies averaging close to $5 billion were provided by China during the past three seasons. During the last three seasons (2011/12, 2012/13 and 2013/14), China implemented a system of minimum support prices by directly purchasing cotton from producers and placing in government strategic reserve. A total of 16 million tons were purchased and stockpiled by the government. Three seasons of implementation of this policy of stockpiling cotton in the government reserves provided support to domestic and international prices and helped to keep world trade buoyant. At the same time, this policy also caused mill use and the market share of cotton in China to shrink. Potential release of the reserves to domestic mills reduces the need for imports and limits growth in world trade. The Chinese government announced that it would end its reserve building policy in 2014/15 and instead provide a direct subsidy to cotton producers in Xinjiang and other provinces. Details of the implementation of the new subsidy program remain unknown at this time.

USA accounts for 13% of world production and for 32% of world exports. There is a long history of U.S. government policies aimed at supporting cotton farmers' incomes through a number of programs, including direct payments.

The new five-year 2014 President Obama signed US Farm Bill into law on February 7, 2014. The 2014 farm bill marks a significant change in farm policies, to an environment in which there are now no guaranteed payments and eligibility for payments will be based on declining prices, crop failures or reductions in revenues. 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. Possibly, in response to the successful case by Brazil at the WTO challenging the US cotton programs, upland cotton was treated uniquely and became the only commodity eligible for the new "safety net" program, the Stacked Income Protection Plan (STAX). STAX provides subsidized revenue insurance to cotton producers and can supplement insurance coverage available through the Federal Crop Insurance program. Producers of other commodities have similar programs called Price Loss Coverage (PLC) and Agricultural Risk Coverage (ARC). The major difference is that producers of other commodities are protected by minimum price guarantees called reference prices and cotton producers are not.

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 the expected income and producers may select coverage in 5% increments. Payments may not exceed 20% of expected revenue. The federal government will subsidize about 80% of the premium. In addition, the federal government will partially subsidize the administrative and operational costs of the insurance companies offering STAX.

STAX was not available until the 2015 growing season (starting in August 2015). In the 2014/15 season, a transition assistance payment will be provided to cotton farmers.

The Marketing Loan Program (MLP) will continue with a marketing loan rate based on the world cotton price, calculated as the simple average of the adjusted prevailing world price for the two immediately preceding marketing years (announced October 1 preceding the next domestic plantings), but in no case lower than 45 cents per pound or greater than 52 cents per pound. If market prices stay above 52 cents per pound there will be no subsidy by the government. The range between 52 and 45 cents per pound serves as a floor price paid to farmers if market prices fall below this range. Prices below 45 cents per pound are below cost of production and could lead to declines in production.

Changes were made to the Short Term Export Credit Guarantee Program (GSM-102) by cutting back the duration of loans from 36 to 24 months. In addition the program is to become more market-oriented, allowing the USDA to charge higher program fees, beyond a level necessary to cover its costs. An annual limit of $5.5 billion has been set for all commodities. The program facilitates US exports of commodities by providing government guarantees to commercial banks that might be unwilling otherwise to provide credits for trade.

The Congressional Budget Office (CBO) projects that government outlays for cotton will be lower under the 2014 farm bill compared with the repealed Direct Payments and Counter-cyclical payments programs of the 2008 farm bill. During the life of the 2008 farm bill government outlays for cotton averaged at $1.1 billion. It is projected by CBO that government expenditures under the 2014 farm bill will average just one third of the expenditures under the 2008 farm bill. Lower expenditures could mean lower support and incentives to produce cotton in the USA and opportunities for competing producers to increase their market share.

In October 2014 the US and Brazil signed an agreement resolving a decade-long trade dispute in the WTO over cotton subsidies. Under the terms of the agreement, Brazil will terminate the Cotton case, giving up its rights to countermeasures against U.S. trade or any further proceedings in this dispute. Brazil has also agreed not to bring new WTO actions against U.S. cotton support programs and the GSM-102 program while the current U.S. Farm Bill is in force. The U.S. will make a one-time final contribution of $300 million to the Brazil Cotton Institute.

World cotton stocks are projected to reach a record of 21.8 million tons during 2014/15 accounting for almost 90% of world mill use. World cotton stocks were at just 8.6 million tons in 2009/10 accounting for 34% of world consumption. 2014/15 will be the fifth consecutive season in which production exceeds consumption. Between 2010/11 and 2014/15, cumulative surplus of production over consumption reached close to 14 million tons. The largest share of the world stocks is held by the Chinese government reserve as a result of three seasons of stockpiling policy. The size of the national reserve was estimated at 11 million tons as of the end of 2013/14. As of the start of 2014/15, total Chinese stocks were accounting for 62% of world stocks and for more than 150% of mill use in China.

Large stock of cotton held mostly by China could continue to depress cotton prices until liquidated and lead to a decline in cotton plantings in major producing countries such as USA, China, Brazil and Turkey. The long-term Cotlook A Index averaged 74 cents per pound since 1976/77. During the last three seasons the A Index averaged 93 cents per pound and is projected to fall to 68 cents per pound in 2014/15 and further to 61 cents per pound in 2015/16. In 2014/15, China discontinued the program of direct market intervention, instead replacing it with direct subsidies paid to producers. As a result, a decline in cotton prices accelerated. It is likely that cotton prices will stay below long-term averages during the next several seasons.

Lower prices could also encourage mill use, as cotton competes with polyester. Developing countries have a potential to increase cotton production as costs of production are lower, but there is a need to increase yields closer to world averages. Major issues must be addressed in order to improve productivity in developing countries, especially in Africa. The most important issues are input availability, technology transfer, and extension, improvements in logistics and regulation.

# Cotton Provisions in the US 2014 Farm Bill, US-Brazil Cotton Settlement and Other Major Developments in the World Cotton Market

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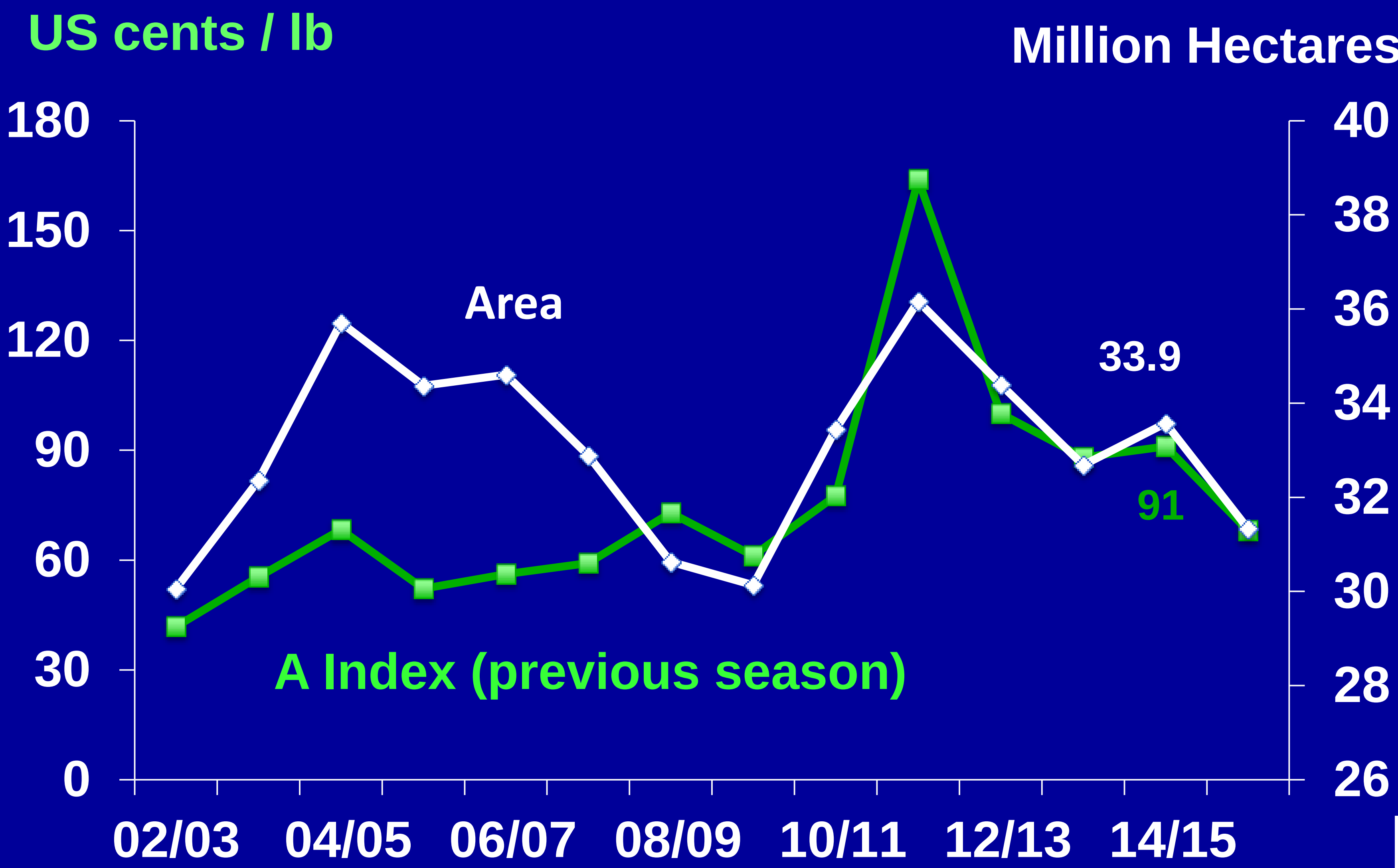
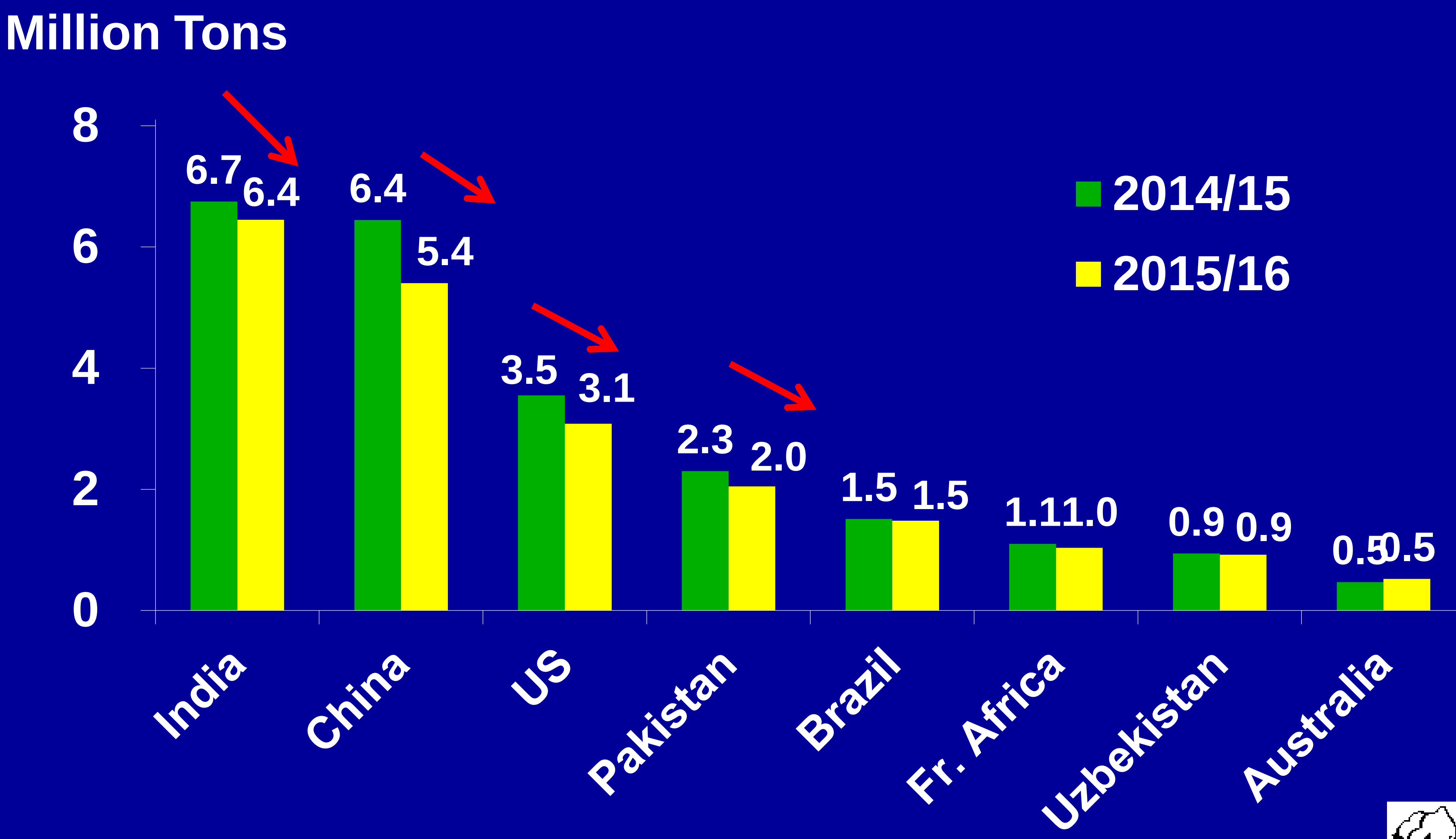
Geneva, April 15, 2015

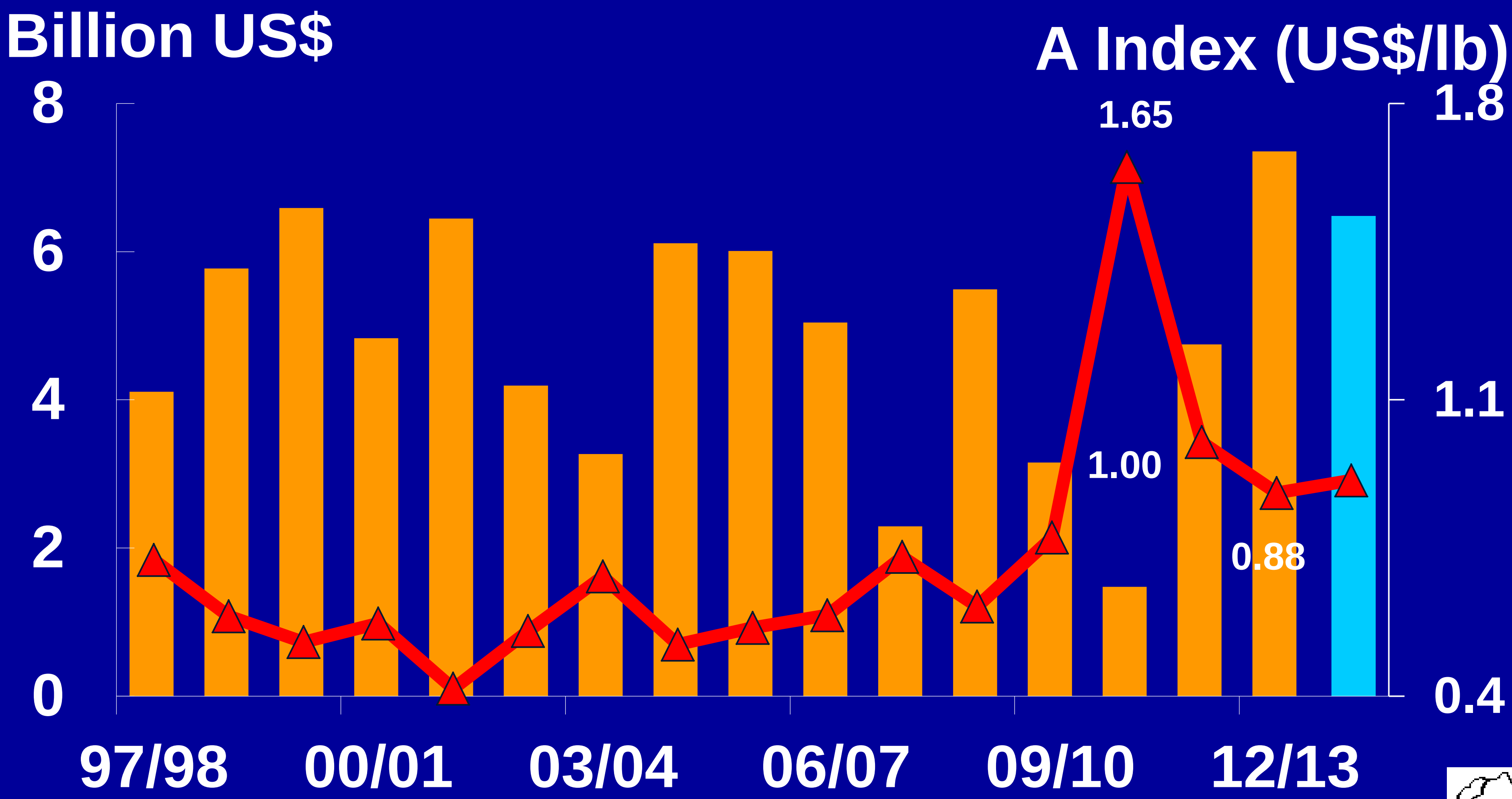
# World Cotton Area and Prices



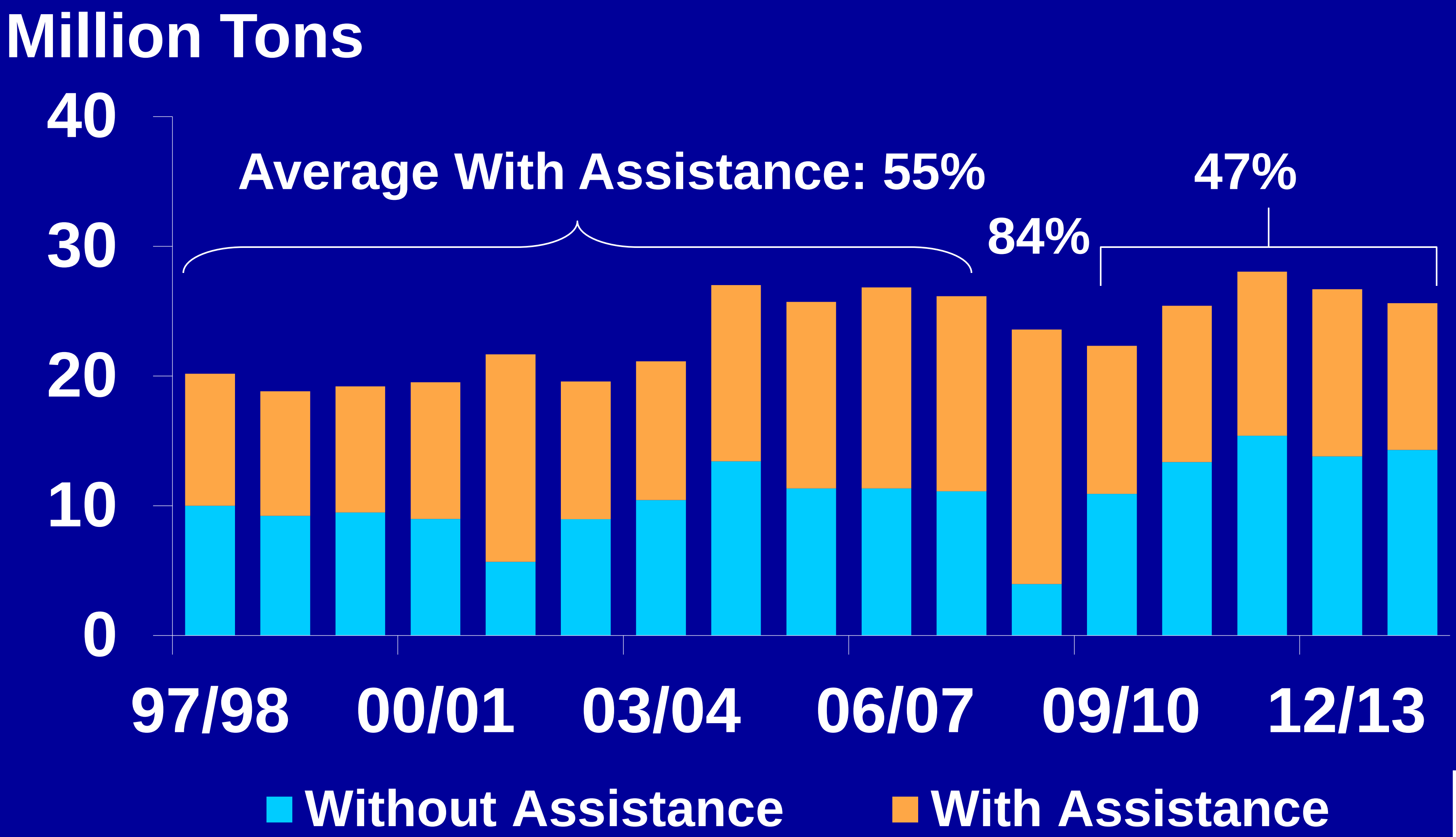
# Cotton Production



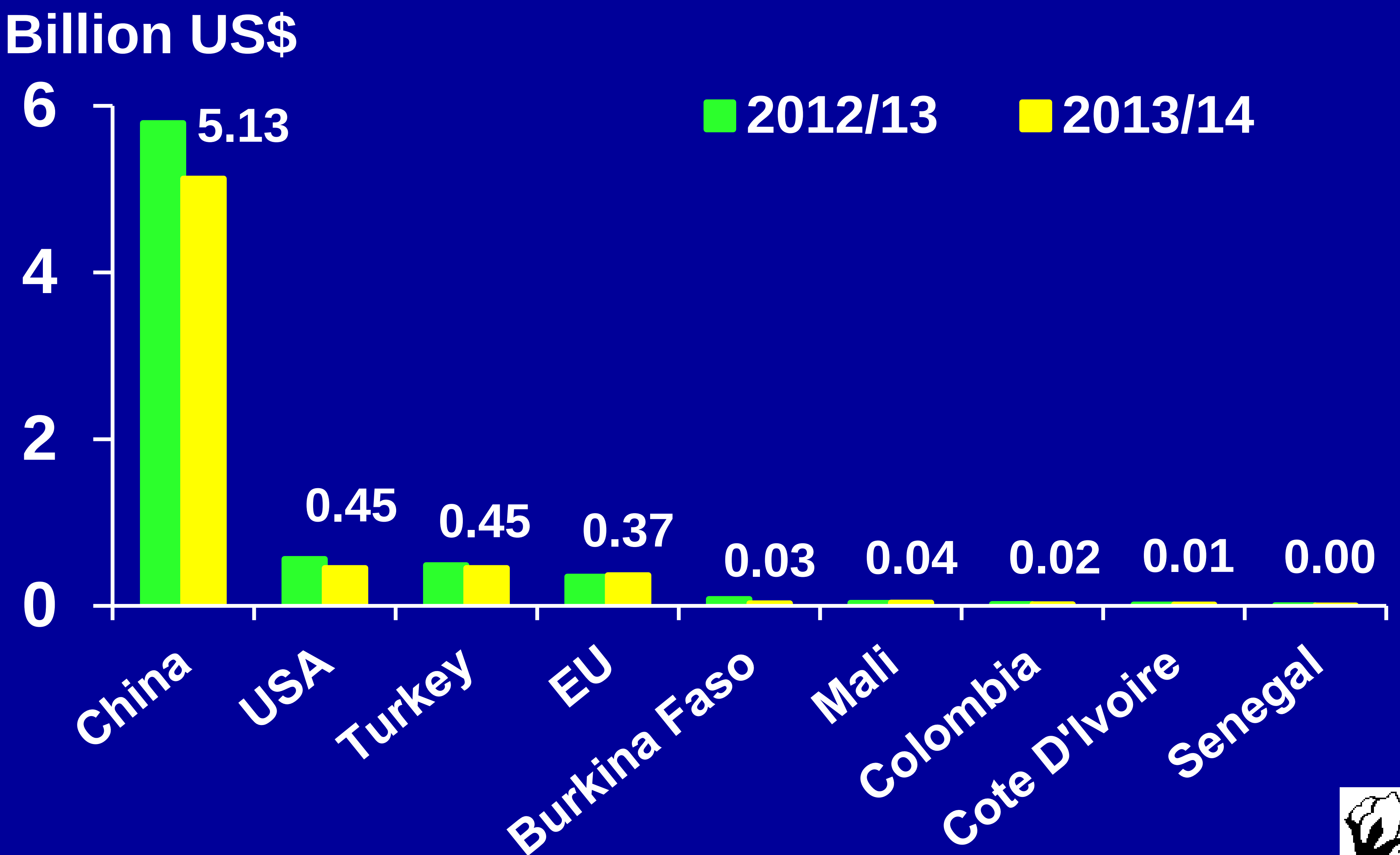
# DIRECT ASSISTANCE TO COTTON AND PRICES



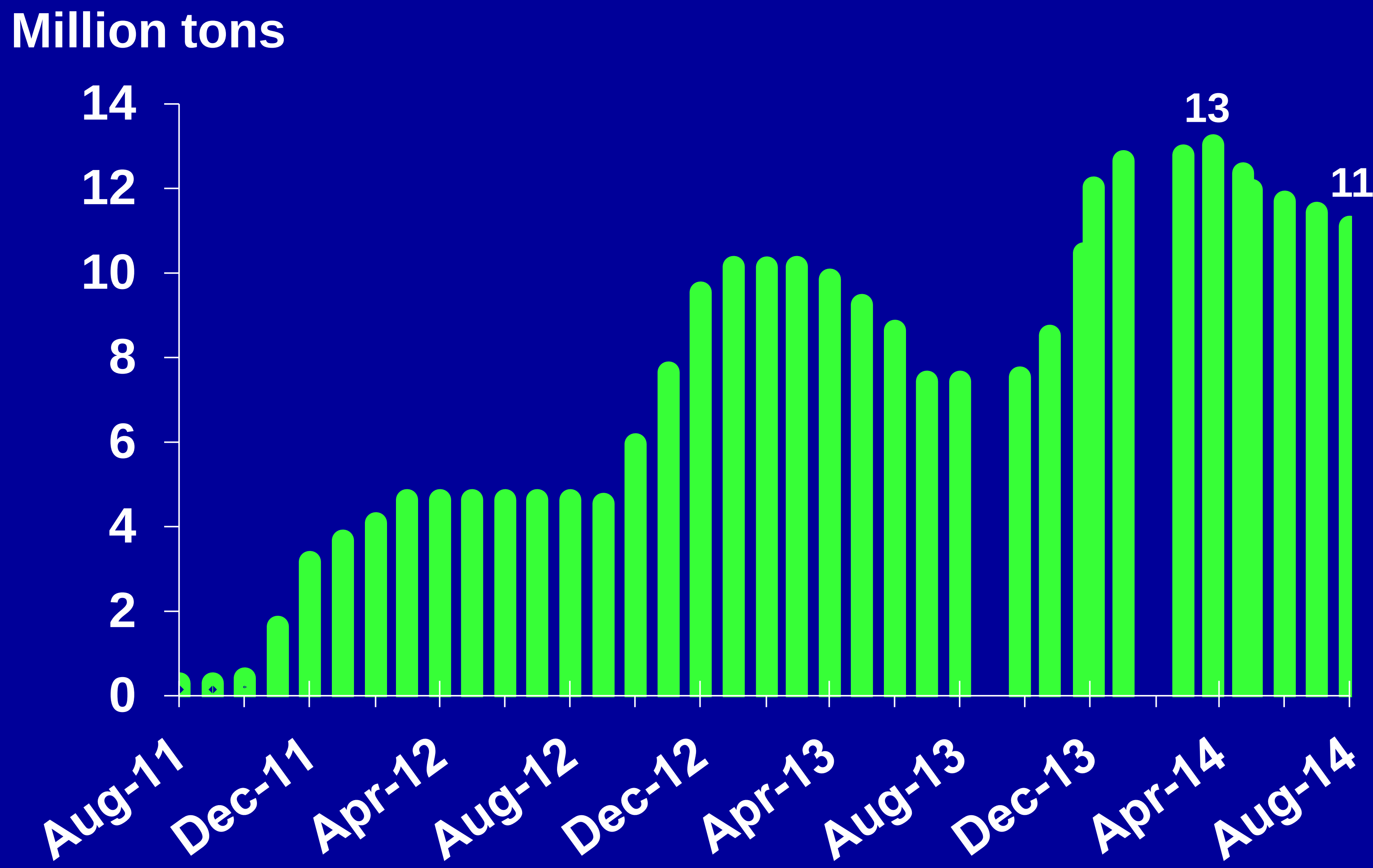
# WORLD PRODUCTION UNDER DIRECT ASSISTANCE



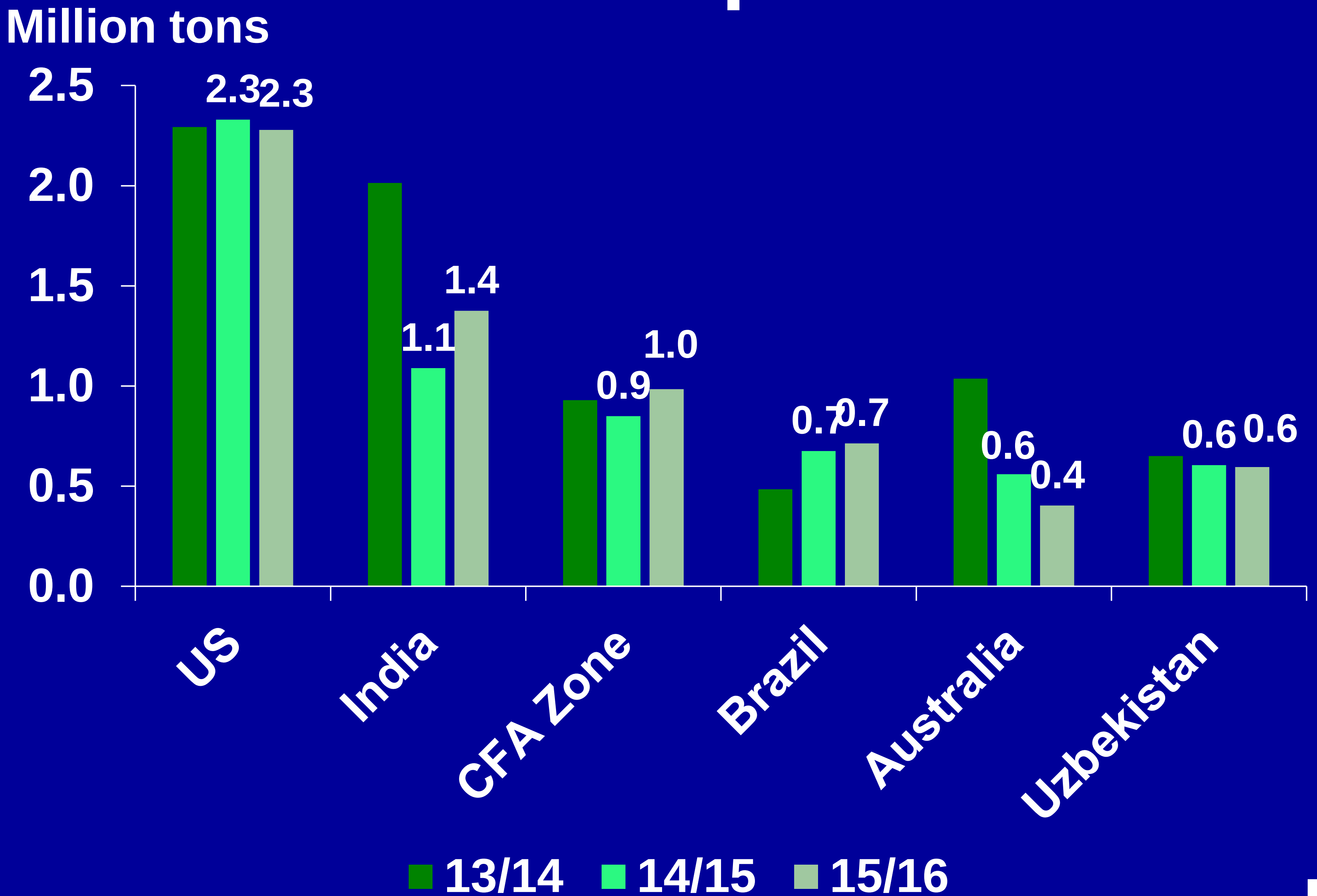
# DIRECT ASSISTANCE TO COTTON



# Estimated Size of China National Reserve



# Cotton Exports



# 2014 Farm Bill

- Eliminated Direct Payments based on Area
- Eliminated Countercyclical Payments based on Target Prices
- Kept Marketing Loan

- Added Revenue Insurance (Price x Yield)

# 2014 Farm Bill

**For Cotton:**

- STAX: Stacked Income Protection Plan

Short-term revenue insurance

(**yield** x price)

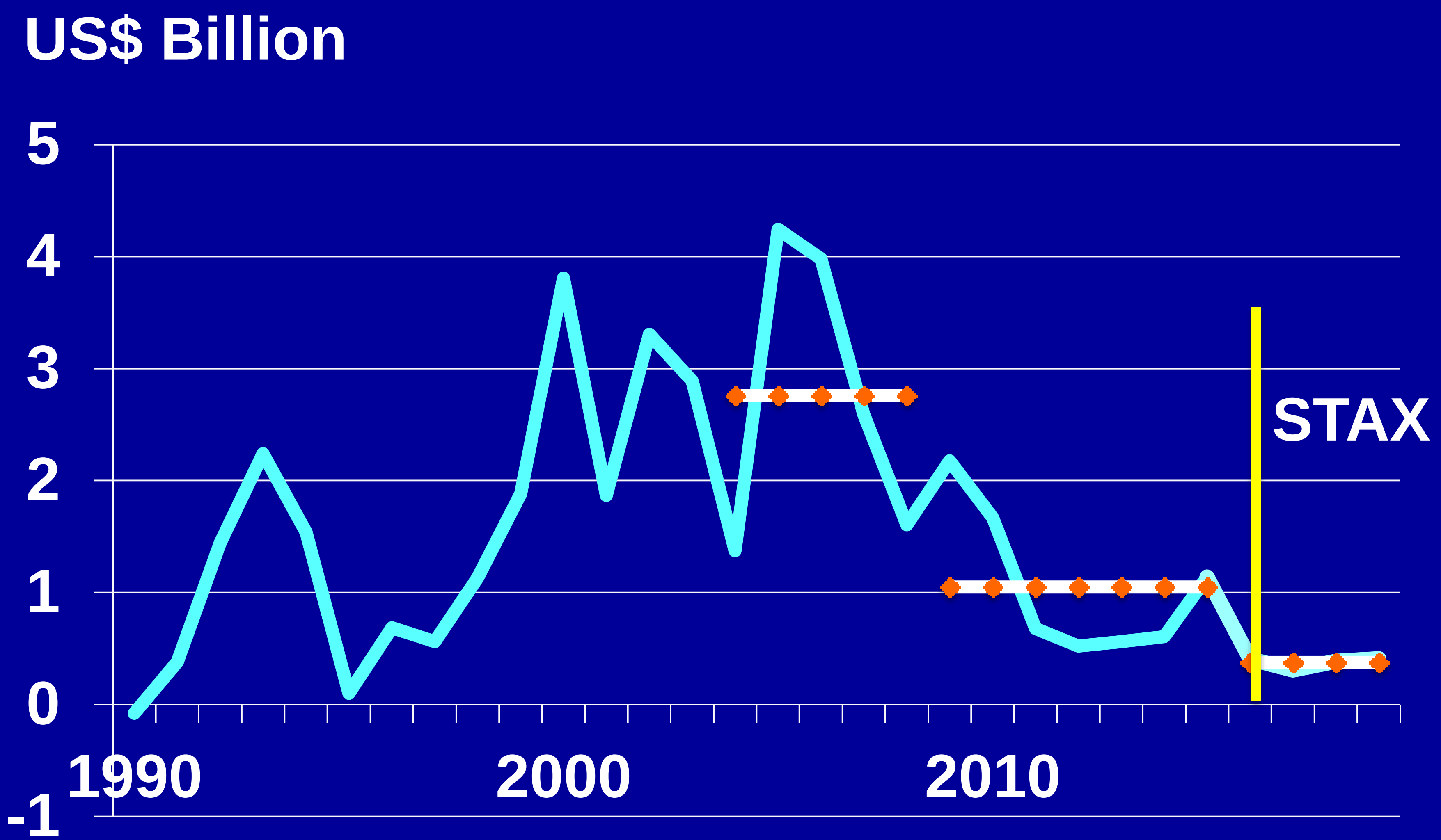
# 2014 Farm Bill

## **For Cotton:**

## **STAX:**

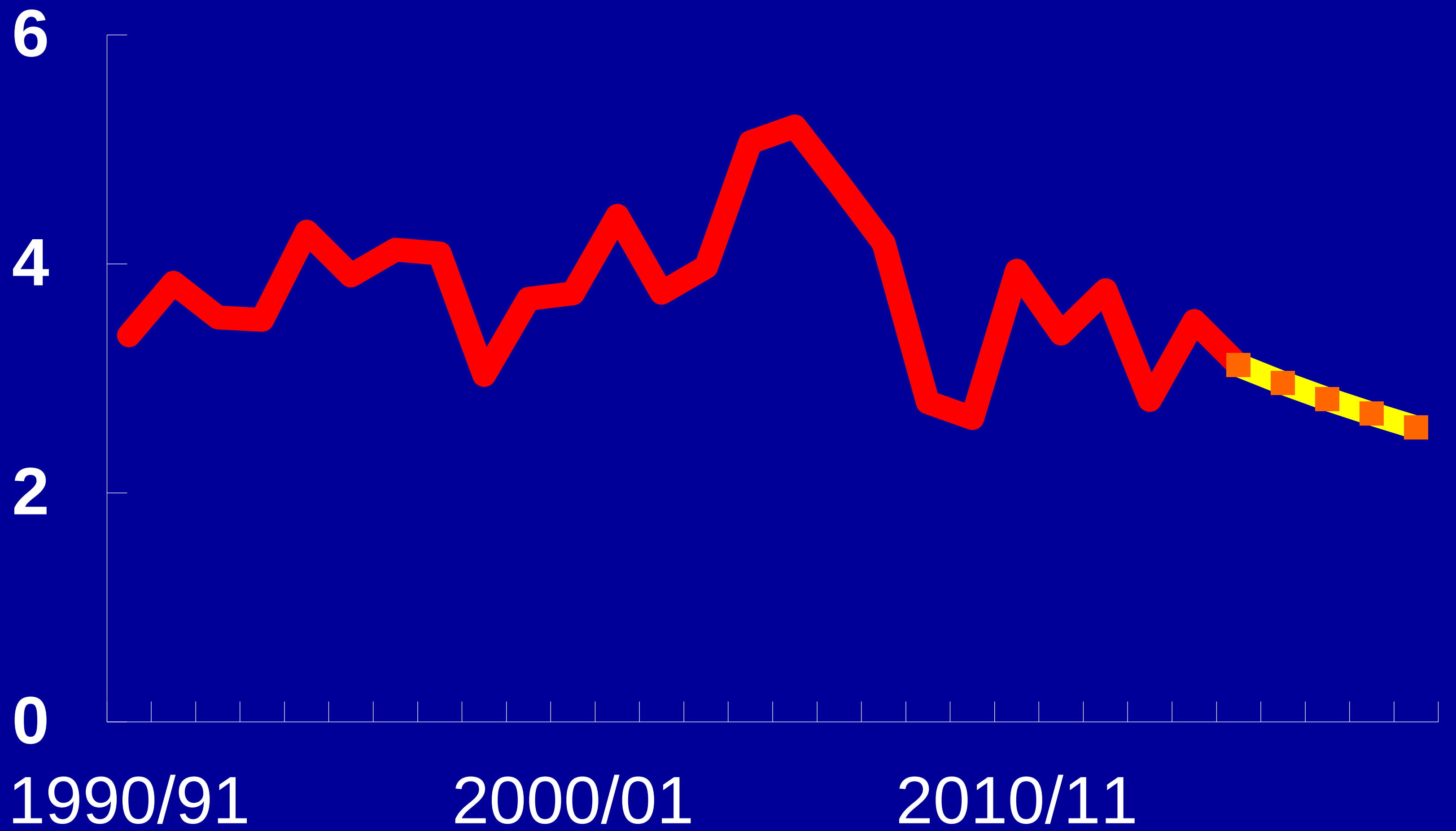
- Yields based on county-wide averages
- Prices based on ICE futures
- Farmers pay 20% of insurance premiums
- Within Season Insurance Coverage Only!
  - (Price declines from one season to the next are not covered)

# U.S. Government Expenditures on Cotton



# U.S. Cotton Production,

## Million Tons

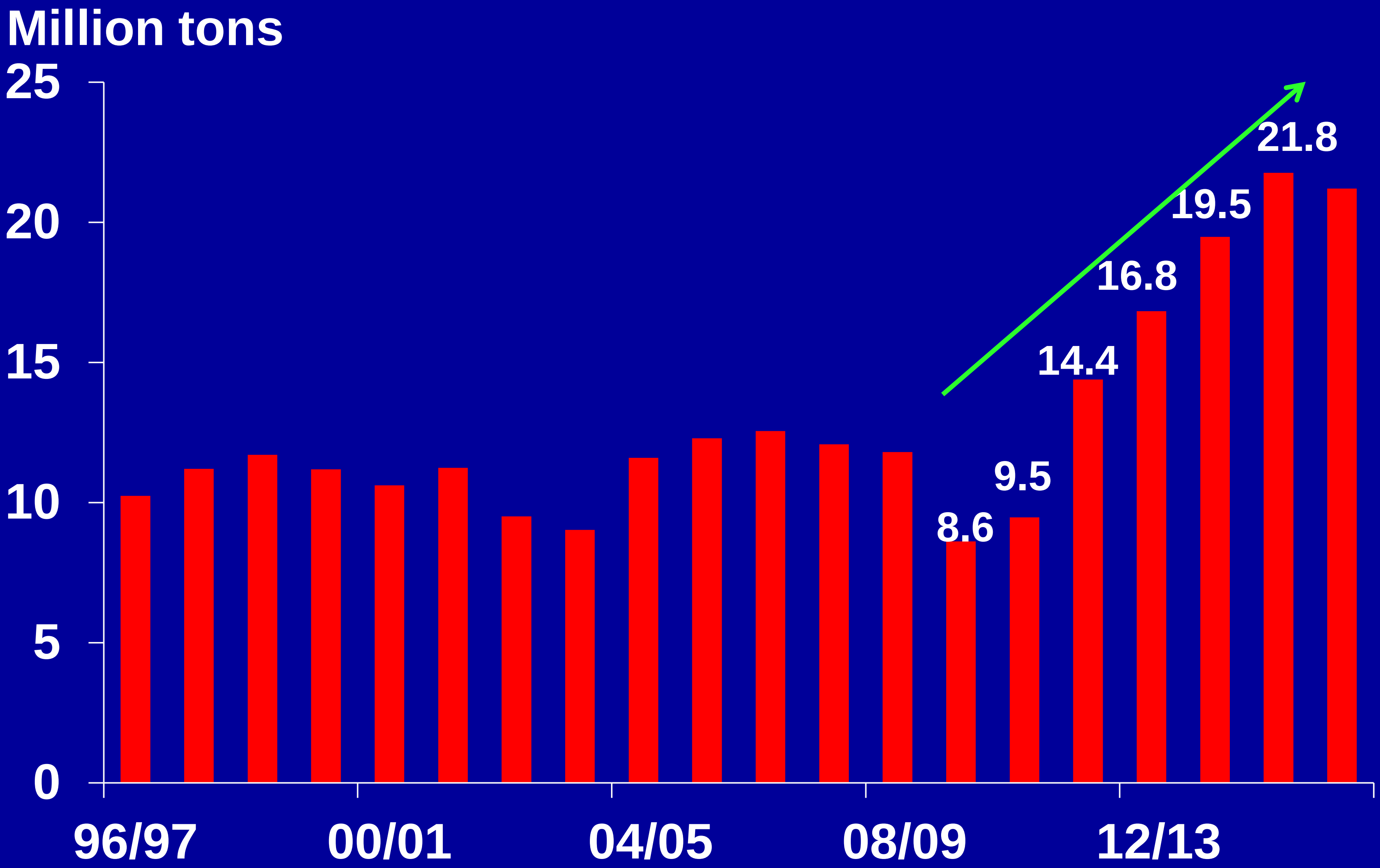


# U.S. – Brazil WTO Cotton Dispute

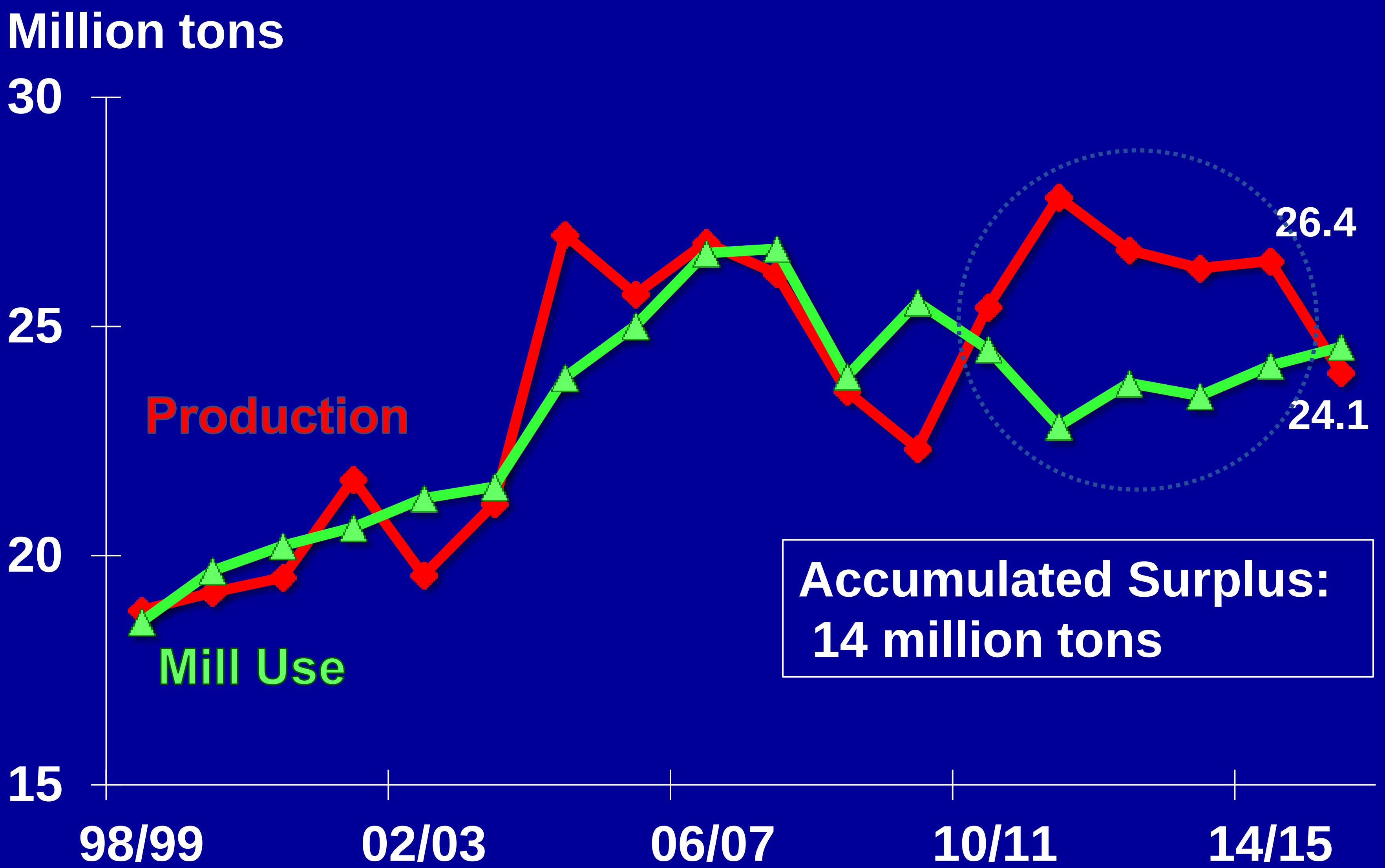
- Agreement Signed on Oct. 1, 2014 to End the Dispute
- The Cotton Case is Terminated
- No New WTO Actions by Brazil Against USA

- U.S. Will Make One-Time Payment of $300 Million

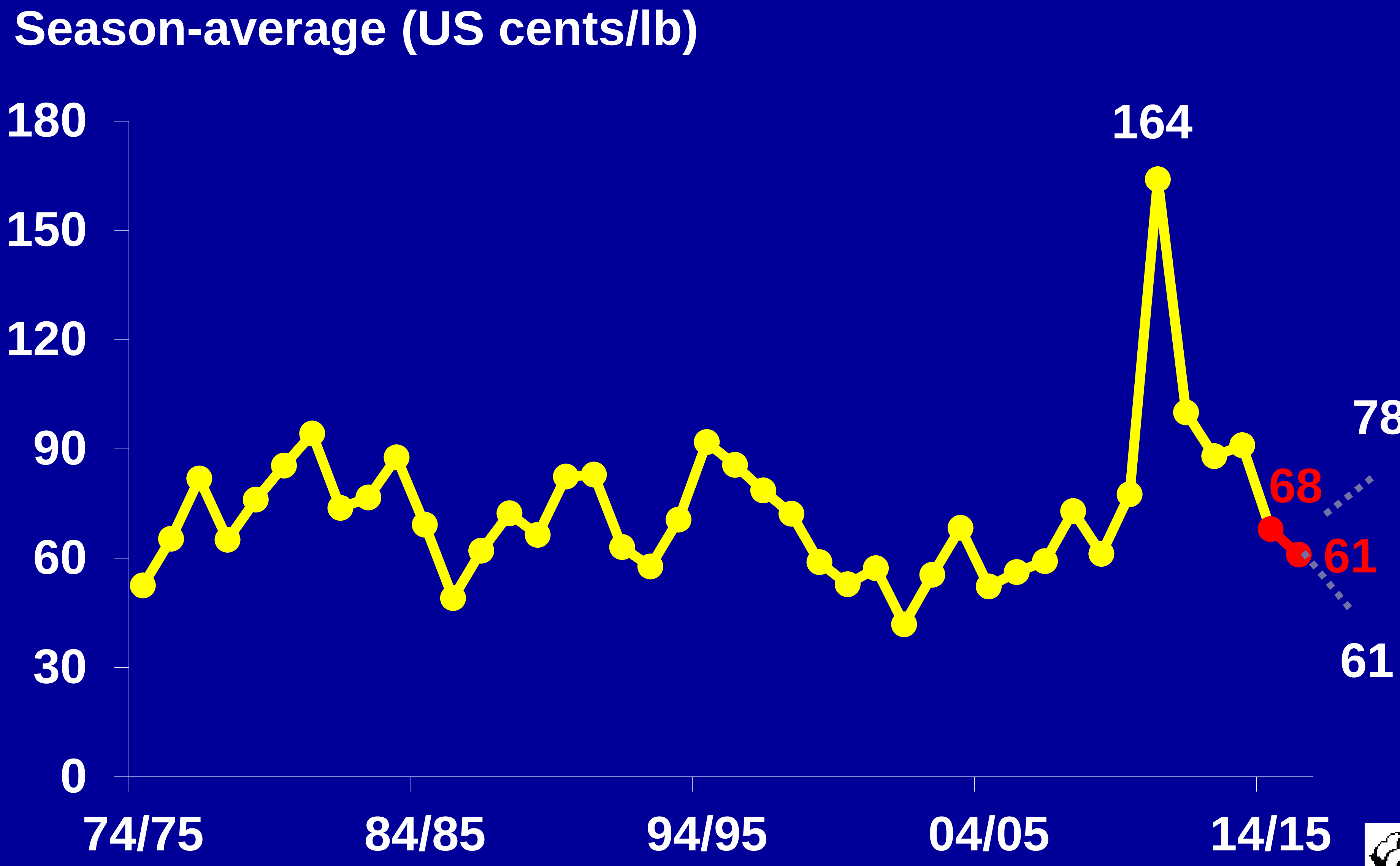
# World Ending Stocks



# World Cotton Production & Mill Use



# Cotlook A Index



# Net Cost of Cotton Production