

Cotton price distortions: Building a case for reform

Summary of papers on reforming the world cotton market

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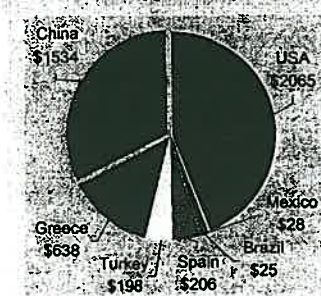
Cotton
RESEARCH & DEVELOPMENT



The international cotton market is highly distorted.

In some major producing countries, up to half of the returns to cotton farmers come from government subsidies. In some cases, the subsidies are counter cyclical so that the recipient farmers never face the realities and disciplines of the world cotton market. These countries also maintain substantial barriers to imports of yarns, textiles and clothing. The consequences of highly protective policies for non subsidising countries are disastrous. When international prices start to fall, there is no supply response in countries, such as the United States, which heavily subsidise their producers. The subsequent over-supply greatly exacerbates the downturn in world prices so that all the adjustment is forced onto non subsidising countries. This in turn causes significant social disruptions, particularly in developing countries.

1 Direct assistance to cotton production 1999–00 (US\$m)



Source: Valderrama Bacerra (2002).

ICAC has an ambitious agenda...

The International Cotton Advisory Committee (ICAC) established a Working Group on Government Measures. This Working Group has an ambitious and laudable agenda “to identify effective strategies to reduce and eventually eliminate the negative effects on trade caused by direct government assistance to cotton production and trade”. The work of this Group should complement that of the WTO under the Doha Round.

... and has made a good start in documenting government measures

that distort production, consumption and international trade in cotton. In 1999–00, around US\$4.7 billion was spent by governments in supporting their domestic producers. The US and China accounted for about 77 per cent of this protection (Chart 1). Recent changes introduced through the US Farm Bill will produce even higher support for US cotton growers — half of their returns will come from government. The US also maintains import quotas on yarns, textiles and clothing. China’s recent domestic price reductions and entry into the WTO will mean lower levels of assistance.

The implications of protection are serious...

When half the returns come from government, with assistance provided in a counter cyclical way, cotton producers grow much more cotton than they otherwise would – in the US, ‘set aside’ programs have been scrapped. Production in subsidising countries is therefore maintained at high levels and this substantially depresses world prices.

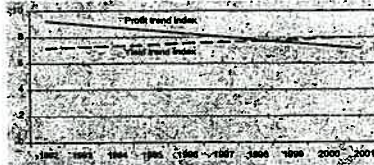
...subsidised producers lose innovation...

Because they respond to subsidies instead of the market, they lose the incentive to innovate. Their new found gains are realised into higher land prices and over-capitalised machinery. The more subsidies they are given, the harder it becomes to ‘wean’ them off.

...and unsubsidised producers get hit hard.

Producers in non subsidising countries take the full brunt of world market adjustments and low prices. Recent Australian work (CIE 2001) indicates that production and export subsidies in the US and China cost each Australian cotton producer about A\$118,000 per year because of lower world prices and consequent lower Australian production. Chart 2 shows that despite increasing yields in Australia, profit margins from growing cotton have been steadily declining over the past decade.

2 Average operating profit



Source: CRDC and Boyce (2001).

Regional communities suffer...because of subsidies. The bankruptcy/failure rate of farmers in subsidised countries is no less than in unprotected free-market economies. But depressed farm incomes in non-subsidising countries have the added impacts of reducing job and economic opportunities in rural communities, leading to population losses and ongoing decline.

...and the effects are even more devastating in developing countries

such as Mali in Africa where cotton makes up nearly half the nation's export income. It is one of the poorest nations on earth and depressed cotton prices have a crippling effect on its fragile economy.

You can't be green if you are in the red.

Depressed farm incomes slow or stop the implementation of on-farm environmental sustainability reforms. Protectionism has negative economic, social and environmental impacts – all components of the triple bottom line.

Exchange rate changes are not protection.

The suggestion that countries which experience devaluation of their currency in effect receive a subsidy is nonsense. In Australia, for example, exchange rates are determined by many factors including domestic inflation. Governments cannot manage exchange rates and cotton exports have no influence on them. While there has been a long term depreciation of the Australian dollar, there have been volatile fluctuations around the trend. Depreciation may benefit returns to cotton producers but costs of imported inputs are raised. The reverse occurs when the Australian dollar appreciates, as is now the case.

Challenges for the ICAC and WTO

The ICAC Working Group needs to concentrate on identifying the harmful effects of subsidies on world cotton markets. It then needs to identify strategies within the context of the WTO to reduce protection. These might include: identifying coalitions of countries adversely affected by subsidies, and combining their knowledge and experiences so that they speak with one authoritative voice; developing the substantive and well researched case for reform; and forming 'new cotton coalitions' to press for reform within the WTO.

References

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