“The Role of Cotton In U.S. Trade Policy”
Remarks
Of
Neal P. Gillen
Executive Vice President & General Counsel
American Cotton Shippers Association
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Three years ago I was invited by the French Government to appear before a Subcommittee of the Assemblee Nationale to explain the U.S. cotton program. I explained in great detail every aspect of the program – every bell and whistle. When I completed my presentation one of the Deputies on the Subcommittee railed about the fact that little had changed since the days of Roosevelt, concluding in his words, “Le programme de coton des Etats-Unis n’est pas pratique.” I responded, “Oui, le programme n’est pas pratique, il est politique. Et, il est juste les mêmes dans l’union européenne.”

I tell that story because everyone should understand that trade discussions are not academic exercises based on economic theory and logic – they are at best efforts by nations to gain an advantage without suffering an economic impact. Most importantly, the advantages gained and the compromises made must result in or eventually yield an economic value to the domestic interest groups most affected by the actions of their government negotiators. In sum, there must be political benefits.

The political constituencies of every Member of Congress expect either to gain or not to lose in a negotiation, and it has become more difficult to make such a case in today’s world. That is why the American people and the Congress are so divided on the issue of free trade.

As I view the political strategy of U.S. agriculture in the Doha Round it is to gain market access similar to that which the U.S. gives the products of our world’s competitors and to maintain domestic subsidies at a level that will provide sufficient protection and allow our producers to compete.

You could say that the level of subsidization is the political tipping point. What complicates the situation is that the E.U. has a similar strategy regarding subsidies, which begs the question – why should U.S. and E. U. producers be subsidized in order to compete?

That being said, I will now talk about the U.S. cotton program and the industry’s views on the current trade round.

Our topic today is “The Role of Cotton in U.S. Trade Policy.” Suffice it to say that the role of cotton has turned out to be more significant than the U.S. industry would prefer. Since the 2003 Cancun Ministerial the U.S. cotton program has been under constant attack in the world media. The U.S. industry, with the full support of USTR, USDA, and Members of Congress familiar with the facts, was impelled to defend itself against a massive disinformation campaign that still continues today. At the same time, the U.S. was defending the Upland Cotton Program before the WTO in Geneva in the case initiated by the Government of Brazil. As you know, the WTO dispute and appellate panels found Step 2, a Competitiveness provision of the Upland Cotton Marketing Loan, to be a prohibited subsidy as applied to both domestic users and exporters. The U.S. Government noted its intention to comply with the ruling and the Congress is now in the process, in the Budget Reconciliation, of repealing the program by phasing it out on July 31, 2006. The Senate Agriculture Committee recommended such action to the Budget Committee on October 19th and the Congress should complete its action sometime in November.

There are other aspects of that decision, still unresolved, pertaining to the “Serious Prejudice” issues, the Marketing Loan and Counter-Cyclical payments, that are currently being discussed by the U.S. and Brazilian Governments as well as in the Doha negotiations. Keep in mind, without Step 2, the cotton program’s marketing loan and counter-cyclical payment provisions are identical to the wheat, feed grain, rice, peanut, and oilseeds programs. This should explain the U.S. position that cotton should not be singled out for separate treatment in the Doha round, but be addressed within the overall agricultural negotiations.

Professor Katz requested that I address the specific aspects of the Step 2 Program that the WTO Dispute Panel found not to be compliant with the Uruguay Round Agreement (URA). The Panel did not find the benefits to growers, an argument put forth by the U.S. in defending the Program, to be violative of the agreement. The Panel found that the Step 2 payment to exporters is a prohibited export subsidy, not protected by the URA “Peace Clause,” and the payment to domestic mills is a prohibited import substitution because it is only made for U.S. cotton.

Addressing the disinformation campaign I urge those following the issue to focus on the principal myth being circulated - that the U.S. cotton program has resulted in overproduction generated by subsidy payments having the effect of reducing world prices by estimates ranging upwards of twelve percent.

First of all, U.S. cotton plantings are determined by the relationship of other crops competing for that land, be it soybeans, corn, sorghum, and in the far west, where cotton land is being abandoned in favor of certain fruits, vegetables, and almonds - a tree crop. Since cotton plantings will range from 12.5 to 14 million acres, the size of the crop will depend on weather and cultivation practices. Yes, it is true that the size of the U.S. crop has increased in recent years, but so too have the crops of our foreign producing competitors. This raises the question, if U.S. production has had a price depressing effect,

then why is world production also increasing? A primary reason is demand for cotton textiles - a demand that is, interestingly enough, centered here in the U.S., where one out of five bales produced in the world is consumed. There are additional factors, particularly the new technologies resulting in increased yields, lower production costs, and more sustainable production.

The rising world production, not the U.S. subsidy program, is the fundamental reason why prices remain below the long-term average. Subsidies in the U.S. are no greater now than they were in the 1980s and 1990s; however, prices are lower despite rising demand because production is expanding at a faster rate.

Continuing with the U.S. subsidy and production myth. Do away with the U.S. cotton program immediately as the West Africans are demanding and everything will be fine. Will it? No - there are many other factors to consider. According to last year's United Nations' Food & Agricultural Organization (FAO) study if you ended the U.S. cotton program the effect on world price would result in a price increase of no more than three to four percent. At today's world price of about 59 cents that would result in a price increase of about two cents per pound. According to the Secretariat of the International Cotton Advisory Committee, the intergovernmental body of the world's cotton producing and consuming nations, that even with the elimination of the cotton subsidy programs in the U.S. and the E.U., world production would adjust within two or three years and the long term impact on prices would be negligible, probably less than the two cents estimated by the FAO as the short term impact. Therefore, the outright elimination of the U.S. and the E.U. cotton programs would result in minimum benefits at best for those making this demand.

What has damaged U.S. and world cotton prices more in recent years were the effects of the 1997 Asian Financial Contagion, which drove down the prices of all agricultural commodities. That price structure is yet to fully recover from this cataclysmic event.

Where the U.S. can be blamed for having an adverse impact on foreign cotton prices, however, is in the weakness of our dollar. Since the world trade in cotton is based on the U.S. dollar, it's value plays a significant role in the revenue earned by foreign cotton producing nations. The fluctuations in exchange rates directly affect the price of cotton converted into local currencies. A weaker dollar aggravates the decline in cotton prices converted in domestic terms. The impact varies from country to country. In the past year, Brazil has suffered the most since the dollar lost about 23 percent on the year against the Brazilian Real resulting in a decline in Brazil's domestic cotton price of 27 percent. In contrast, the dollar only slipped by 5 percent in Australia, and by 3 percent in Argentina. This too, is where the West African cotton producing nations were impacted, beginning at the outset of 2002, when the dollar began its decline, through July of this year. During that period the prices in domestic currencies in the African franc zone fell by about 12 percent. Clearly, the value of the dollar plays a larger role in real terms for foreign cotton producers.

Despite these clear and obvious facts certain WTO leaders – all politicians or former politicians – by ignoring these facts are doing a disservice by insisting on separate consideration of cotton in the Doha Round. The same WTO leaders feel that by making cotton the scapegoat that other issues will be overlooked – important issues like market access.

While market access is not a problem for cotton, it is for some of the other crops produced by many cotton farmers, particularly corn, soybeans, and other oilseeds. China, while a substantial importer of U.S. cotton does pose significant market access problems, not only for the U.S., but for all of the world's cotton exporting nations, particularly in China's administration of its dysfunctional TRQ system that operates through a bizarre licensing system, which precludes Chinese cotton buyers from acting freely in the world market to address their supply needs. Though China processes approximately 40 percent of all the cotton produced in the world its textile manufacturers are forced to suffer through a hand-to-mouth supply system that precludes them from utilizing forward purchase contracts and other risk management tools often resulting in their paying a higher price for cotton.

Another problem that China must address is its failure to adhere to the intent of its WTO Accession Agreement. When that Agreement was before the Congress, officials of the Chinese Government represented that the TRQ system would be administered as follows: one third of all imports would be allocated to Government Trading Companies and the remaining two-thirds would be allocated to the private sector. In implementing that system, however, the Chinese violated the letter and the spirit of the Accession Agreement. How? They required that of the two-thirds allocated to the private sector that 60 percent of the yarn or textiles produced from that imported cotton would have to be re-exported and that only the remaining 7 percent could be consumed within China. The result of this policy has produced an interesting and disturbing anomaly. While the manufacturing of cotton in China has increased, the actual level of cotton consumption in China is decreasing. Meanwhile, the world is awash in Chinese textile goods and the adverse economic impact on textile manufacturing in both the developed and the developing world has been significant – an unfortunate, but anticipated result of globalization.

I think that is enough about China. Let me get back to the WTO and sum up. At some point, hopefully soon, the WTO leaders will have to come to grips with the realities of the situation and address market access if they want an agreement. Otherwise, there will not be one.

Hopefully, we will not squander the opportunities that a satisfactory agreement offers both the developed and the developing world. If there is no agreement, the WTO will have failed. Further, such a failure will have the effect of hobbling the power of future U.S. Presidents to consider comprehensive trade agreements - because when the current fast-track trade negotiation authority expires in 2007, I have serious doubts that the Congress will reenact it.

That, in my opinion, explains the bold nature of the Administration's proposal to reduce trade distorting subsidies by 60 percent over the next five years and eventually eliminate all subsidies and tariffs in the next 15-years. My sector of the cotton industry views this action as a negotion tactic designed to engage the principal player – the E.U. – in meaningful negotiations. Time is of the essence, and I personally believe, from the Administration's standpoint, that it had little choice – it had to make a bold move at this juncture if the Doha Round is to be saved. Though I do not speak for production agriculture, its reaction is not surprising – farmers feel betrayed, having believed the Administration's commitment to maintaining the provisions of the 2002 Farm Bill. Farmers also understand that times are changing and that program reductions are inevitable. What farmers demand, however, is fairness in the overall approach of any comprises reached in the Doha Round and the 2007 Farm Bill.

Summing up, cotton is not the issue. The real issue is overall reform, in export and domestic subsidies and in tariffs or market access. Further, my initial anecdote about my exchange with the French Deputy gets right to the ultimate resolution of this trade round – there will be no agreement unless and until the E.U. makes concessions acceptable to the United States and its elected officials. The same holds true for the developing nations.

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