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Informed Analysis, Expert Opinions

Executive brief

Cotton sector

1. Background and key issues

While the USA remains the world's largest cotton exporter, in 2012–13 Chinese cotton sector policies have come increasingly to overhang global cotton markets, with Chinese reserves accounting for 63% of global stocks. Chinese support policies, by making duty-paid cotton imports attractive to Chinese textile manufacturers, have supported the global cotton price in 2012–13.

While the ACP accounts for only 5% of global cotton production, cotton remains of considerable social and economic importance in the main ACP cotton producers – Benin, Burkina Faso, Chad and Mali, known as the C4 group. Cotton production in West Africa is projected to show strong growth in marketing year 2012/13 (+41%), and these gains should continue in 2013–14, but at a slower rate.

In Eastern and Southern Africa, a 21% decline in cotton production in 2012/13 is forecast, and this decline is due to continue into 2013/14, following reduced production across the region.

While China now provides the highest overall level of cotton sector support, the EU continues to provide the highest level of support per tonne of production. The expansion of scope for the provision of coupled support, as part of the June 2013 political agreement on CAP reform, could see coupled payments in the cotton sector increased in the next 7 years. This does not bode well for early progress on cotton issues in the WTO, which remained stalled over 2012–13. The US, however, remains central to any substantive movement on cotton issues in the WTO.

Given the influence of Chinese policies on the functioning of global cotton markets, drawing China more substantially into cotton reform discussions in the WTO can be seen potentially as an important priority for the ACP Group's efforts to move cotton issues forward in the WTO.

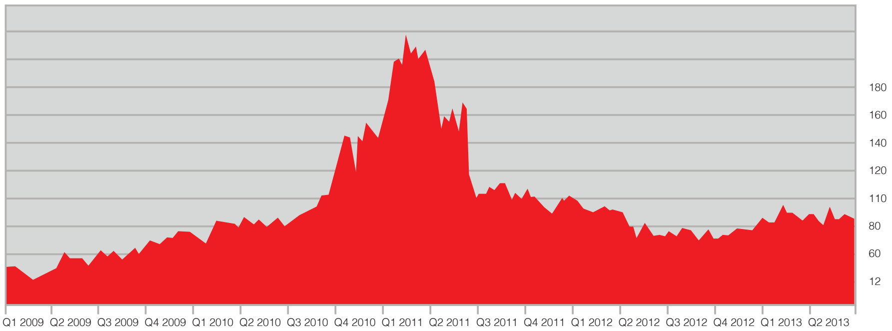
2. Latest developments

Developments in global cotton markets 2012–13

In a continuation of the trend evident since 2010/11, global cotton production will again exceed consumption in 2012/13, ending

> *"Cotton production has exceeded consumption for the last 3 years"*

Figure 1: Cotton price trends on the New York futures market, 2009-13 (US$/lb)



Source: Reuters

slightly below 2011/12 levels at 26.39 million tonnes. After 2 years of decline, consumption recovered sharply in 2012/13, increasing by 7% to 27.78 million tonnes, with growth in India, Bangladesh, Turkey and Pakistan partially compensating for a fall in the world's leading consumer, China. Global cotton stocks grew for the third year in a row, with almost 60% held by China, and the same trend is already apparent for 2013/14, with China's share projected to rise to 64%. According to the International Cotton Advisory Committee's (ICAC's) estimates, global production will fall by just over 5% to 24.95 million tonnes. It will decline in the United States (a year-on-year reduction of 17% in the planted area), China, Brazil and Australia, while remaining steady in India, Pakistan and Uzbekistan. Consumption is expected to grow by just over 2% to 24.33 million tonnes.

Cotton prices were extremely volatile during 2010 and 2011, jumping in the space of 6 months from 85 US cents/lb to a record high of 243 cents/lb before falling back sharply. In contrast, prices since early 2012/13 have been relatively stable. The Cotlook A index opened in August at 81.65 cents/lb and fluctuated between 80 and 85 cents until February. It then began to rise, reaching a high of 99 cents/lb in March 2013, before dropping to 90 US cent/lb in April–May and recovering in mid June to 96 cents/lb. Prices overall have ranged from 80 to 99 cents/lb during 2012/13, at an estimated average of 88 cents/lb (ICAC), 12 cents/lb below their 2011/12 level.

"Less market volatility has led to fewer breaches of contract"

Less volatility has led to fewer breaches of contract: only 52 contracts were subject to International Cotton Association (ICA) arbitration, compared with 135 in the first quarter of 2013 (and 247 for the full year, breaking the previous record of 242 set in 2011). Prices are relatively high given the current market fundamentals of substantial stocks and supply exceeding demand. This is largely as a result of Chinese policy, which will continue to determine trends in 2013 and 2014. With over 60% of cotton stocks held in China (USDA), stock-to-use ratios elsewhere are relatively tight.

"China holds 63% of world stocks"

China maintained its policy of producer support in 2012/13, by guaranteeing a minimum purchase price above global levels and rebuilding its national reserve stocks. China's opening stocks had almost tripled to over 6 million tonnes and have since experienced further growth, with higher than anticipated levels of imports pushing stocks to 10 million tonnes by the beginning of 2013/14 (USDA June 2013 estimates).

The actual level of imports is projected to fall from 5.2 million tonnes in 2011/12 to 4.3 million tonnes in 2012/13, and China has also been selling off part of its reserve stocks since January 2013, with sales expected to close at the end of July.

Over recent weeks China's Middle Kingdom has made no secret of the fact that it is contemplating policy changes (see *Agritrade* article 'Changes in Chinese cotton policy imminent?', 15 July 2013). The priority for China's policy makers until now has been to support its producers and stabilise the market. But the price has perhaps been too high, particularly for China's textile industries.

The cotton issue at the WTO: 2012–13 developments

The most recent consultations at the WTO over development assistance to the cotton sector are not subject to appeal: "The 'Cotton-4' and other sub-Saharan producers stated on 21 June 2013 that they regret the lack of movement in the negotiations to cut cotton subsidies and to open markets." The next opportunity will occur at the forthcoming WTO Ministerial Conference in Bali in December, where the C4 countries are expected to table a new proposal.

"The cotton dossier in the WTO negotiations is at a standstill"

The stalemate over cotton is one aspect of the deadlocked negotiations over the wider Doha Round.

Cotton sector subsidies in western countries are also under scrutiny, with

Outlook for cotton in 2022

What will the cotton market look like in 10 years' time? In their 'Agricultural Outlook 2013-2022', the FAO and the OECD have for the first time included projections for cotton. While China and the United States are expected to maintain their status as leading consumer and producer respectively, the decade is likely to see significant changes. Consumption is projected to increase at an annual rate of 1.7%, below the long-term average, with a rate of 7% expected in India. It is not expected to reach the 2004 record of 26.7 million tonnes until 2022. Production is forecast to grow more slowly than demand, with a significant fall in China and growth in India and Pakistan. Trade is expected to fall. However the LDCs of sub-Saharan Africa are projected to increase their share of the global export market, overtaking India to become the world's second largest exporter behind the United States. Meanwhile China's share of the global import market will fall by half, with countries like Bangladesh and Vietnam taking up the slack. Finally, prices are projected to increase by 47% relative to the period 2000/09, reaching an average of some US$1395/t. However, they will not be as attractive as those offered by wheat and maize.

discussions currently in progress over CAP reform and the new US Farm Bill (see section 'Developments in the European cotton sector, 2012–13' below).

In the United States, the two houses of Congress failed to agree a new Farm Bill for 2013/18. In response, the 2008/12 Farm Bill, with a budget in excess of US$288 billion, was extended until 30 September 2013, the deadline for the approval of its successor. Some elements of the new Farm Bill appear to be settled: the budget, at around US$939 billion over 10 years, substantial cuts to subsidies and an increase in crop insurance. However, as of early July, the Senate and the House were still divided, especially over the issue of food stamps. The Republicans in the House of Representatives suggested splitting the Farm Bill as a way forward, and on 11 July the House passed the Bill, shorn of its food stamp clauses. Will this be sufficient to gain a yes vote in the Senate and ultimately White House approval?

As far as cotton is concerned, the reform marks a change from direct payments to crop insurance programmes. Crop insurance will be complemented by the Stacked Income Protection Plan for Producers of Upland Cotton (STAX), proposed by the National Cotton Council (NCC) to cover smaller losses, and uncontested on 11 July. The NCC argues that STAX will benefit cotton growers while also providing a basis "for a definitive resolution of the dispute with Brazil and the WTO". In an interim agreement until the new Farm Bill comes into force, the US is making annual compensation payments of US$147.3 million to Brazil, which is still contemplating retaliatory measures if the new bill fails to meet its expectations. Studies conducted by the International Centre for Trade and Sustainable Development (ICTSD) show that in certain circumstances a crop insurance system combined with STAX could increase American spending on cotton when prices are low.

While the steady increase in Chinese support for the domestic cotton sector has worked to keep the market stable and prices relatively high, especially during 2012/13, the past decade has also seen a negative correlation between levels of subsidy and the Cotlook A Index, particularly for the US and Europe.

"By including cotton in its duty-free, quota-free access for LDCs, China could increase the competitiveness of African cotton"

However, an ICAC/ICTSD Information Note suggests that by including cotton in its duty-free, quota-free access to markets programme for LDCs, China could increase the competitiveness of African cotton relative to other regions by making it duty free. Apart from the annual quota of 894,000 tonnes set as part of its WTO obligations, China's duties on imported cotton currently range from 5 to 40%.

Despite the continuing stalemate at the WTO over the cotton issue, there has been an increase in the amount of aid received by African countries. In May 2013 the total disbursements directly linked to the cotton sector reached US$453 million – US$321.3 million to completed projects and US$131.7 million to current projects – a rise of US$64 million over December 2012. Despite the increase in disbursements, the Africans still consider the figure too low (a 36% disbursement-to-commitment ratio for the US$365.6 million committed). In terms of development aid to agriculture and associated infrastructure, the total value of commitments has risen to US$6.9 billion, an increase of US$1.9 billion over December 2012.

The Africans have highlighted the importance of South–South cooperation, giving particular thanks to China (Chinese assistance is not included in the figures above). Brazil signed a US$20 million partnership agreement with the WTO in 2012 to transfer knowledge and expertise in cotton cultivation and trading to producers in developing countries by providing technical assistance and best practice training. Similarly, India has allocated a budget of US$5 million for the period 2012–14 to the Cotton Technical Assistance Programme for Africa, based in Ouagadougou.

Developments in the European cotton sector, 2012–13

Cotton production in Europe has fallen sharply since the 2006 reforms and now lies close to mid 1980s levels at 300,000 tonnes, or 1% of global output.

In 2011/12, however, production grew by over 40% to 347,500 tonnes. In Greece, responsible for around 80% of Europe's cotton crop, it rose by 42% over the previous year to 290,000 tonnes, due to an increase in the planted area (+20%) and improved pest control. The planted area remains unchanged for 2012/13, but a fall in production is forecast, with yields cut by bad weather and lower use of fertiliser. For Greece and Spain as a whole, production is expected to fall by nearly 7% to 325,000 tonnes.

> *"Producers in Greece and Spain are abandoning cotton production"*

Early estimates for 2013/14 suggest both countries will experience a substantial fall in the planted area and thus in production, expected to drop below 300,000 tonnes to 255,000 tonnes, an annual decrease in excess of 20%. In Greece, and especially Thessaly, growers preferred hard wheat and maize, which are cheaper to produce than cotton and whose price jumped from €0.22/kg in July 2012 to €0.26/kg in February 2013. In Spain too, growers have opted for the higher returns offered by maize. The price of cotton, which fluctuates year on year, has already fallen from €56.35/100kg in 2012/13 to €42/100kg. In addition, the so-called Article 69 payments, which supplemented coupled payments, were discontinued for 2013/14.

The average level of subsidy received by European countries is the highest in the world. According to ICAC estimates, direct subsidies to Greek cotton producers reached US$266 million in 2011/12, down from US$280 million in 2010/11, or 43 US cents/lb of fibre, down from 70 cents/lb in 2009/10. The comparative figures for Spain are around US$89 million in 2011/12, down from US$93 million in 2010/11, or 67 cents/lb of fibre, down from 98 cents/lb in 2009/10.

> *"With the reform of the EU CAP, there are concerns over the flexibility of coupled support in the cotton sector"*

Inter-institutional debate within the EU over CAP reform is likely to result in greater flexibility for individual member states in their use of CAP policy measures. This is a particular concern in the area of coupled support: for example, in the cotton sector, it would potentially undermine the efforts made at the WTO on behalf of the ACP nations by the C4 group of African producers to obtain more rigorous discipline in the use of subsidies (see *Agritrade* article 'The current state of CAP reform negotiations', 17 June 2013).

Developments in the ACP cotton sector, 2012–13

Central Africa and West Africa

> *"Central Africa and West Africa are experiencing a cotton revival"*

Central Africa and West Africa are experiencing a cotton revival, with 2012/13 production figures confirming the upturn first seen in 2011/12. The planted area grew by 33%, production by 41% and exports by 42%, increases underpinned by generally favourable climatic conditions, proactive policy choices with high farm-gate prices, the continuing subsidisation of inputs, and better growing practices.

Burkina regained its position as the region's leading producer with 630,000 tonnes in 2012/13, a 51% increase over 2011/12. Sofitex reduced the area planted to GM crops by 60% after problems with silk length, and a sowing plan was implemented, developed by Burkina's Agricultural Research Institute in conjunction with the growers themselves and Monsanto. An awareness campaign was also launched encouraging growers to supplement mineral fertilisers with organics, since GM cotton requires extra fertiliser. Burkina Faso has agreed a 730,000-tonne production target for 2013/14.

The upturn also gathered pace in Côte d'Ivoire, with production of 340,000 tonnes in 2012/13, a 30% rise over 2011/12, and a target of 400,000 tonnes in 2013/14, close to levels obtaining before the political crisis. The agricultural sector is a priority for the government – including cotton, which is grown in the north of the country. A Cotton and Cashew Industry Management Council has been set up to reform the sector. Following the model adopted for the cocoa sector in January 2012, it will focus its attention on growers. It aims to offer them higher returns on the sale of their crop and growers will thus receive 60% of the international price. The project will be accompanied by a special development fund designed to increase production to 600,000 tonnes in 2016, and a buffer fund, on the Burkina Faso model, is also envisaged.

Table 1: Cotton fibre production trends in sub-Saharan Africa ('000 tonnes)

	2011/12	2012/13*	2013/14*
Francophone Africa	**717**	**1011**	**912**
- Benin	75	158	151
- Burkina Faso	174	260	92
- Cameroon	78	100	151
- Côte d'Ivoire	113	140	133
- Mali	187	229	211
Anglophone Africa	**633**	**503**	**461**
- Mozambique	61	37	27
- Nigeria	63	57	56
- Tanzania	120	97	80
- Zambia	110	74	65
- Zimbabwe	142	119	107

Note: *estimate
Source: International Cotton Advisory Committee (ICAC), March 2013

Benin experienced considerable uncertainty in 2012/13, with the government eventually resuming control of the industry and sidelining Patrice Talon, a key figure in cotton, involved at every stage of the supply chain and particularly in the import of inputs. The government was unable to turn things round at such short notice and production was limited to 250,000 tonnes instead of the anticipated 600,000 tonnes. However, this still represented an increase over the 2011/12 figure of 175,000 tonnes. Togo, too, was unable to reach its target of 100,000 tonnes, production remaining steady at 80,000 tonnes. In Mali, the CMDT consolidated its gains despite the conflict, with production of 453,000 tonnes, almost identical to the previous year. The target for 2013/14 is 522,000 tonnes. For the six countries of West Africa (Benin, Burkina Faso, Côte d'Ivoire, Mali, Senegal and Togo) as a whole, production figures of approximately 1.8 million tonnes in 2012/13 are forecast to grow by +20% to 2.1 million tonnes in 2013/14.

In Central Africa, Chad enjoyed marked growth in cotton production, driven by its cotton sector improvement programme for 2012–2016. Chad's cotton processing company, CotonTchad, took a number of measures at the beginning of 2012/13, collecting and paying for the previous year's seed cotton, ordering inputs, etc., and the result was a 50% increase in production to 120,000 tonnes. In Cameroon, production was affected by floods in 2012/13. However, it still grew by 19% to 220,000 tonnes and Sodecoton's target for 2013/14 is 260,000 tonnes. The company conducted its first trials of GM cotton in 2012 and a joint trade association for cotton is being planned. The association is in theory to start work in 2013, bringing together Sodecoton and the National Confederation of Cotton Producers of Cameroon (CNPCC).

East Africa and Southern Africa

In contrast to West Africa and Central Africa, cotton production in East Africa and Southern Africa fell sharply in 2012/13, with no sign of an upturn for 2013/14. Between 2011/12 and 2012/13, production dropped by 22% and the planted area by 17% – the consequence of a 2011/12 season marked in several countries by tensions between growers and millers, as well as falling prices that turned growers away from cotton.

In Tanzania, the system of contract farming central to its cotton sector reform seems mired in disputes. Problems were already apparent in 2012 (see *Agritrade* article 'Contract farming strengthens functioning of Tanzanian cotton supply chain', 4 June 2012), but during 2013 these became political. The Tanzania Cotton Association (TCA) accused some politicians and cotton buyers of conducting an anti-contract farming campaign that, by encouraging farmers not to sell their cotton below a certain price, has contributed to a potential 40% drop in this year's cotton harvest. With lower yields and a 26% reduction in the planted area from 2012, production is unlikely to exceed 240,000 tonnes in 2013, down from 354,000 tonnes in 2012.

Unfavourable weather and a move to alternative crops, soybeans in particular, mean that Zambia is also expecting a fall in production – by some 30% to approx. 175,000 tonnes (275,000 tonnes in 2011/12) – as well a 27%

reduction in the planted area. However, in 2012/13, the government for the first time included cotton in its Farmer Input Support Programme (FISP), a scheme which has already helped to increase maize production.

"There has been a fall in production in Eastern and Southern Africa"

The same trend is evident in Zimbabwe, with a fall of 25% to approx. 260,000 tonnes.

Mozambique has experienced a sharper reduction, with a fall of approx. 46% to 110,000 tonnes, down from the 184,000 tonnes achieved in 2011/12, a year when annual production almost tripled, according to the Cotton Institute. However, the industry is continuing to attract investment. China Africa Cotton Mozambique Ltd (CACM) began construction work on a 30,000-tonne capacity ginning mill in Subue in the province of Sofala in May 2013. Meanwhile Singapore's Olam, having concluded production agreements with 70,000 growers and recently joined the Better Cotton Initiative, is looking to extend its investments in Mozambique's agricultural sector, and in May 2013 began work on a third ginning mill. According to the Mozambican Cotton Institute, the Japanese firm Nitura also has plans to build a textile complex and supply it with raw cotton by opening up 4,000 hectares in the Malem district.

In Angola, the government launched a programme to renovate, modernise and expand its textile sector. Three businesses are involved: the renovation of Textang II is currently under way, with completion anticipated at the end of 2013, and Africa Textil and Satec will follow. The Japanese Bank of International Cooperation (JBIC) is providing the finance, with a US$1 billion line of credit. Meanwhile, the government also wants to ensure the domestic supply of raw materials by encouraging cotton growing, particularly in Malanje and Kwanza Sul provinces, with targets of a planted area of 100,000 hectares and annual production of 40,000 tonnes of cotton fibre.

3. Implications for the ACP

ACP countries must continue to lobby against cotton sector subsidies

Against a background of falling cotton prices in 2011/12, subsidies increased overall to US$4.5 billion (ICAC estimate), or 17 US cents/lb, up from US$1.4 in 2010/11. Ten countries paid subsidies, with China (US$3.1 billion) far ahead of the United States (US$819 million), Turkey ($428 million) and the EU (US$355 million).

"Subsidies are continuing to hamper trade and damage ACP countries"

Subsidies are continuing to hamper trade and damage ACP countries. Chinese policy over the past 2 years has to some extent mitigated the impact of the subsidies paid by OECD members. However, the United States is the leading global exporter and a direct competitor of the ACP countries. As ICTSD makes plain, developing countries dominate the cotton sector in areas such as utilisation (96%), imports (97%) and production (81%), but are nevertheless responsible for only 52% of global exports. African countries, although price takers, still have to compete directly in export markets with developed nations. Subsidies reduce the competitiveness of African cotton, especially as Africa is now losing out to countries like India and Australia in terms of cost and delivery time with the shift in its main export market from Europe to Asia. However, the ACP countries must also work to increase their competitiveness.

ACP countries must keep up with Chinese policy developments

Any change in China's current policy of supporting domestic cotton producers and building up its national reserve stocks could have a damaging effect on the ACP countries.

"Any change in Chinese policy will have an impact on the markets"

Chinese policy has undeniably worked to support international prices at an artificially high level and any rethink could provoke price falls. The first signs of such a change are now appearing, with the experimental payment in April of targeted subsidies direct to cotton growers in Xinjiang in an effort to halt falling production.

This would have an immediate impact on the ACP countries, which are unprotected and export the majority of their production as raw cotton. However, China has maintained its policy of buying domestic cotton at a price of 20,400 yuan/tonne (€2,504/t), and although farm-gate prices in franc-zone Africa have fallen slightly, they are still relatively high. Chinese production, and global production in general, is projected to fall in 2013/14. With consumption rising, supply and demand are expected to be in equilibrium. However, stocks remain high and will grow further still.

ACP countries must secure preferential third-country access for their textiles

Renewal of the third-country fabric provisions of the Africa Growth and Opportunity Act (AGOA), which expired on 30 September 2012, was only secured after a fierce struggle.

> *"AGOA's third-country fabric provisions are vital to Africa's textile industry"*

The Act was eventually passed in August 2012 for a period of 3 years, although only after an intense lobbying campaign and more than a year of delays. The AGOA will remain in force until 2015, but any renegotiation of its terms would badly affect the African textile industry, especially in Kenya, Malawi, Lesotho and Tanzania. LDCs which benefit from the AGOA can buy thread and fabric on the global market and export finished garments manufactured from these raw materials to the American market duty free: 86% of African garment exports to the United States depend on these provisions, and the problematic renewal process has already had a negative impact on the Africa–US garment trade.

The struggle will begin again when negotiations resume over the renewal of the AGOA and its third-country fabric provisions in 2015. President Obama confirmed his support for the AGOA when he visited Africa in June 2013 and indicated that he is interested in finding ways of ensuring that it is renewed and improved.

Tackling the problem of sustainability criteria

Organic cotton first took off in the 1990s. However, the mid 2000s brought new initiatives, such as Fairtrade International (FLO), Cotton Made in Africa (CMIA) and Better Cotton Initiative (BCI), which seemed to resonate with consumers and the big textile manufacturers, although certified cotton still represents only a fraction of the market (2.2% of global production in 2011/12). These certification initiatives vary by approach and geographical area, but all of them aim to make cotton more sustainable and socially responsible, and to increase the return to growers.

The past 2 years have seen a fall in the global production of organic cotton, although India still dominates, with 75% of the market. Several countries are expressing their reservations about organic cotton, particularly Tanzania, the leading African producer (c.75% of Africa's organic crop), which experienced a fall in production (including conventional cotton) in 2012/13. Organic yields are smaller, and the price premium when paid (and this is not always the case) is not enough to compensate.

> *"Organic cotton is in turmoil"*

Some growers are also finding it difficult to secure a market for their cotton. African countries, unlike India and Turkey, do not benefit from an integrated textile industry. They are price takers for organic cotton and conventional cotton alike. Without medium-term contracts to guarantee sales, growers will not stay in the market. Only Fairtrade cotton offers a minimum price and a price premium to the grower, but the brand seems to be marking time, since most of its cotton is also organic. Both certifications impose costs not applicable to the alternative CMIA and BCI marks, which consequently enjoyed considerable growth in 2010/11 and 2011/12. However, none of these initiatives guarantee a market to the producer. All imply additional costs, and they remain subject to supply and demand.

Compliance with these sustainability criteria can offer African producers price premiums and attractive opportunities, but it seems these are by no means guaranteed. Any ACP producer wishing to go down this route must ensure that the price premiums offered for organic cotton provide effective compensation for lower yields and the costs of certification. The development of textile industries in cotton growing countries would also leave growers less vulnerable to external market trends.

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About this update
This brief was updated in October 2013 to reflect developments since September 2012. Other publications in this series and additional resources on ACP–EU agriculture and fisheries trade issues can be found online at http://agritrade.cta.int/

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