U.S. Cotton Economic Situation and Issues Update

Prepared by the National Cotton Council of America
March, 2005

Executive Summary

Cotton production occurs on approximately 30 thousand farms and covers more than 13.5 million acres. In 2004, record yields led to a U.S. crop of 23.0 million bales, the largest on record. In recent years, the demand base for U.S. fiber has shifted from the domestic market to the export market as increased imports of cotton textile and apparel products has reduced domestic mill use. For the current marketing year, the U.S. textile industry will spin 6.3 million bales of cotton fiber into yarn. This is down from 11.4 million bales in 1997/98. Exports of raw fiber are estimated at 13.0 million bales, or two-thirds of total use. With the removal of textile import quotas and China's continued emergence as the largest spinner of raw cotton, the reliance on exports is expected to continue for the foreseeable future.

One of the most significant policy challenges facing the U.S. cotton industry is the dispute brought by Brazil in the WTO. On March 3, the appellate body upheld virtually all of the rulings of the dispute settlement panel in Brazil's challenge of the U.S. cotton program and the export credit guarantee program. The Council is disappointed with the ruling by the WTO appellate body as we believe that several aspects of the findings are inconsistent with the intent of the Agriculture Agreement and are inconsistent with long-standing interpretations of that agreement. Even though we disagree with the decision, the U.S. cotton industry values a rules-based international trading system. While there will be no immediate changes in the U.S. cotton program, we will work with Congress and the Administration to formulate an appropriate response to this decision.

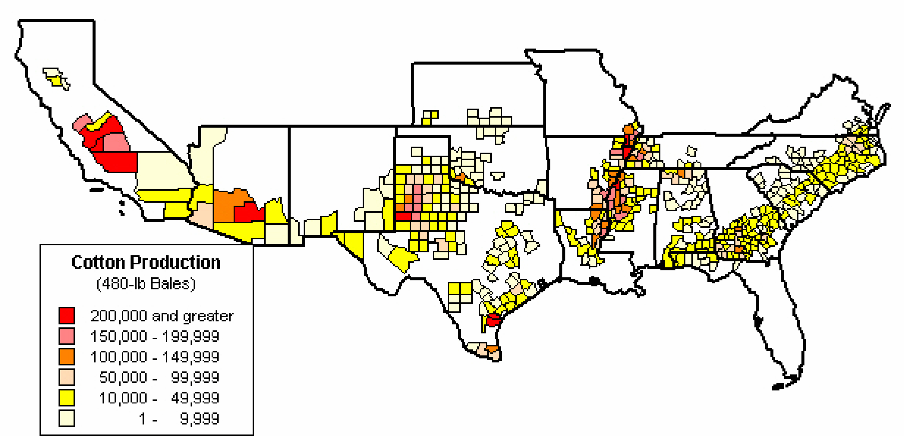
Response to the WTO ruling in the Brazil case can also have implications on the ongoing negotiations of the Doha round. Overall, the current Doha framework agreement seems to contain sufficient structural flexibility to maintain an effective farm program, but U.S. negotiators must ensure that any domestic support reductions beyond the initial year continue to move global subsidies toward harmonization and are not unfair to U.S. agriculture. The Council supports a comprehensive agreement that involves all member countries and all commodities and does not single out the U.S. cotton program.

The 2002 farm bill provides an important safety net for agriculture in a fiscally responsible manner. The Council strongly supported passage of the bill, and at the halfway point, the legislation is a resounding success. The legislation remains vital to the structure and stability of the U.S. cotton industry and U.S. agriculture as a whole.

Introduction

The National Cotton Council is the central organization of the United States cotton industry. Its members include producers, ginners, cottonseed processors and dealers, merchants, cooperatives, warehousemen, and textile manufacturers. While a majority of the industry is concentrated in 17 cotton producing states, stretching from Virginia to California (Figure 1), the downstream manufacturers of cotton apparel and home-furnishings are located in virtually every state. Cotton is the basic resource for thousands of consumer and industrial products manufactured in the U.S. and throughout the world, and the contribution made by cotton to the food and fiber industry continues to grow in importance.

Figure 1. U.S. Cotton Production



Cotton production occurs on approximately 30 thousand farms and covers more than 13.5 million acres. The farm-gate value amounts to more than $6 billion with total business revenue estimated at $40 billion (Figure 2). Apparel production is the primary end-use of cotton fiber with home furnishings ranking second and the remainder going into industrial products. An often-overlooked component of the crop is the vast amount of cottonseed that is produced along with the fiber. Annual cottonseed production averages 7.1 million tons. More than 9 billion pounds of whole cottonseed and cottonseed meal are used in feed for livestock, dairy cattle and poultry. And more than 800 million pounds of cottonseed oil are used for food products ranging from margarine to salad dressing.

Figure 2. U.S. Cotton Industry Profile

	Businesses	Jobs	Revenue
Farms	31,433	173,447	6,115,526,776
Gins	1,018	42,511	802,388,570
Merchants	327	2,844	8,297,276,000
Warehouses	336	9,939	277,795,000
Cottonseed Oil Mills	44	1,520	1,104,641,145
Textile Mills	1,559	213,095	23,545,105,000
Total	**34,717**	**443,356**	**$40,142,732,491**

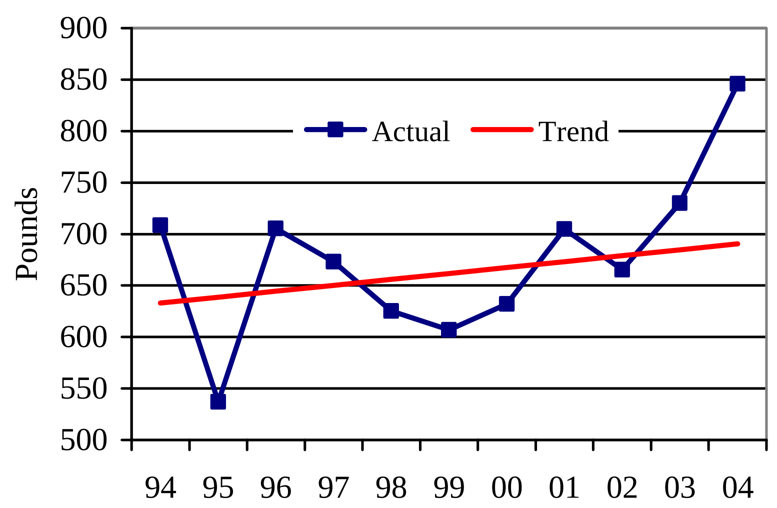
Overview of the Cotton Market Situation

There is no shortage of challenges and uncertainties shaping the economic outlook for the U.S. cotton industry. World and U.S. cotton prices fell throughout 2004, and ended the year some 20 cents lower than at the beginning. The lower prices came in response to a world crop that is now estimated at just under 118 million bales. Most major production regions experienced above average crops with record production in China, India, Pakistan, and the United States. Although mill use is projected to be at an all-time high, it is still expected to fall well short of production. As a result, ending stocks on July 31, 2005 will be at their highest level since the end of the 2001 marketing year. Furthermore, stocks held outside of China will be at their highest level on record.

U.S. Cotton Production

For the 2004 crop year, U.S. production is pegged at 23.0 million bales. Although plantings were only 1 percent above 2003, lower abandonment and record yields led to the 4.8 million bale recovery. Favorable growing conditions were a primary factor behind the record yields. Most parts of the Cotton Belt received adequate rainfall. Portions of west Texas saw one of the wettest years on record, with dryland cotton producing yields comparable to those of irrigated cotton. The national average yield is estimated at an astounding 846 pounds per acre, 116 pounds higher than the previous record set in 2003 (Figure 3). While favorable weather is a big reason behind the higher yields, the occurrence of back-to-back record setting yields suggests that other factors beyond weather are responsible. For example, the use of new higher-yielding varieties, coupled with widespread success of boll weevil eradication, has likely contributed to the higher yields. The larger crop will more than offset smaller beginning stocks, giving larger cotton supplies for the 2004 marketing year than any time in history.

Figure 3. U.S. Cotton Yield



For 2005, the acreage survey conducted by NCC economists estimate U.S. cotton acreage at 13.7 million acres, only 0.6 percent higher than the 2004 level. Assuming normal abandonment and yields, projected production is 18.9 million bales. Adding in beginning stocks and imports, total supplies for the 2005 crop year would be 26.2 million bales.

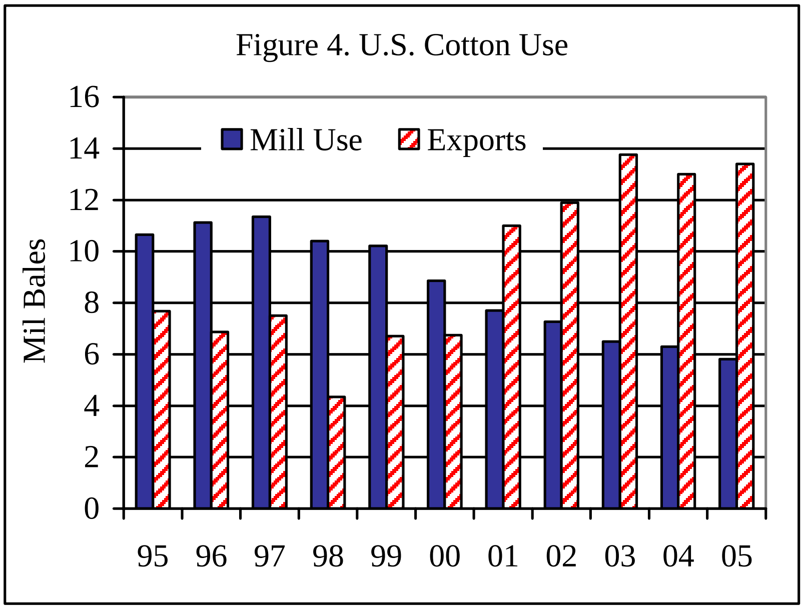
U.S. Cotton Mill Use

The contraction of the U.S. textile industry continued in 2004, but at a slower rate. Domestic mill use for the 2004 crop year is estimated at 6.3 million bales, 190 thousand bales below the 2003 level (Figure 4). The latest losses come on the heels of six consecutive years of losses that averaged more than 800 thousand bales per year.

On January 1, 2005, fiber markets entered a new environment with the elimination of all remaining quotas on textile and apparel trade. Based on past experiences where developed economies have eliminated quotas, China has claimed a significant share of the textile imports into those countries. It is widely expected that, over time, similar trends will occur in textile and apparel products shipped into the U.S. and European Union. In fact, for categories in which quotas were eliminated in 2002, China has already claimed more than 70 percent share of imports to the U.S. Initial data for the month of January are already lending support to the concerns of the textile industry. Exports of cotton shirts and trousers from China to the U.S. are up by more than 1,000 percent from the January 2004 levels.

In general, the elimination of quotas will lead to greater concentration in textile production and trade, with fewer countries supplying a greater percentage of global trade. While China is expected to be the largest winner, India and Pakistan are also expected to be beneficiaries of the post-quota environment.

For the U.S. textile industry, the removal of quotas increases the competition from imported cotton textiles, and will also lead to further downward pressure on retail prices. As a result, further declines are expected for the domestic textile industry. NCC economists expect mill use to fall to 5.8 million bales for the 2005/06 marketing year. As a result, exports will continue to be relied upon as the primary outlet for the U.S. crop.



U.S. Cotton Exports
Exports for the current marketing year are expected to total 13.2 million bales. Mexico and Turkey are currently the top customers, but additional purchases by China are needed to ensure that the marketing year total is reached. For the 2005/06 marketing year, the export projection of 13.4 million bales, if realized, would be the second largest on record, falling just short of the 2003/04 level of 13.8 million bales. The combined level of mill use and exports in the coming marketing year are expected to slightly exceed the size of the U.S. crop. This will lead to a 300 thousand bale decline in U.S. stocks.

World Cotton Market Situation
The world situation, as estimated by USDA for 2004/05, is driven by a record crop of 117.7 million bales. USDA estimates world mill use will increase to 106.2 million bales. The growth comes in response to increased purchasing power driven by a stronger world economy. In addition, weaker cotton prices, at the same time that manmade fiber prices have increased, are encouraging more consumption.

China is the giant of the world cotton industry, producing 25 percent and spinning 35 percent of the world's cotton. In addition to its importance in sheer volume, China's cotton sector adds a dimension of unpredictability to world cotton trade. Uncertainty about China's likely trade position stems from both the diffuse structure of China's cotton industry, which makes it difficult to gather reliable information, and from frequent shifts in government policies affecting cotton. China's erratic and changing policies were especially significant factors affecting world cotton markets and prices between 1999 and 2002. China has alternated between being a net exporter and a net importer over the last 30 years, and world prices have been strongly correlated with these shifts in trade. World prices (the A-Index) had a 62 percent correlation with China's net imports during 1977-2002 (Figure 5).

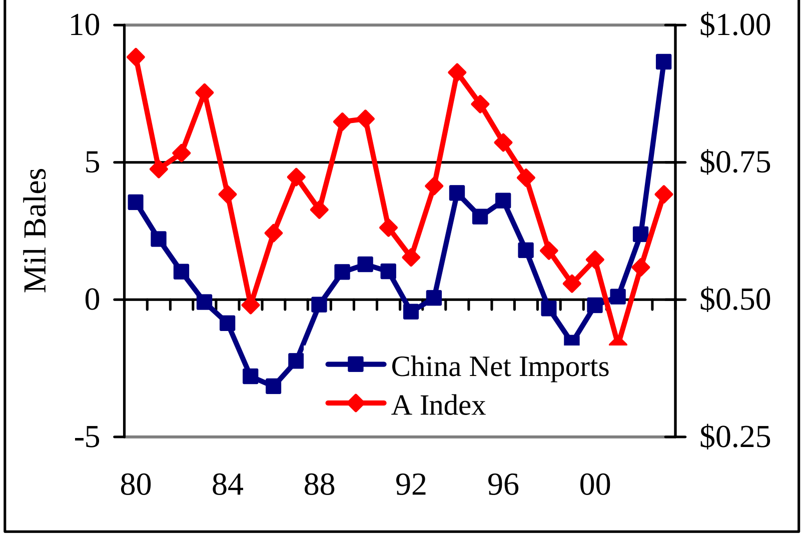


Figure 5. China Net Trade vs. World Price

Mill use in China continues to show strong growth, with expectations of 2004/05 put at 37.5 million bales. This is 5.5 million bales more than the 2003/04 level. While efforts were taken to slow China's economy by restricting credit and bumping interest rates, those actions do not appear to have slowed their domestic textile industry.

USDA also estimates that India and Pakistan will increase their use of cotton in 2004/05. The two will combine to spin almost 25 million bales of cotton. It is the case that just under 60 percent of the world's cotton is spun in China, India, and Pakistan, and the percentage should increase in the post-quota environment.

For 2005, weaker cotton prices will lead to a decline in harvested acreage. This, combined with the assumption of average yields, lowers world production to 104.6 million bales, a drop of 13 million from 2004. In order of contribution, the U.S., Pakistan, China and India account for almost 10 million bales of the decline. In contrast, Australia is one of the areas expected to see a larger crop in 2005, but this is largely based on the assumption that yields return to more normal levels.

For 2005/06, mill use is projected to reach 106.4 million bales, approximately 600 thousand bales above 2004/05. The current estimates for production and consumption would lead to a decline of global stocks by July 31, 2006. The global stocks/use ratio is projected at 42.2 percent, down from 44.2 percent for the 2004 marketing year.

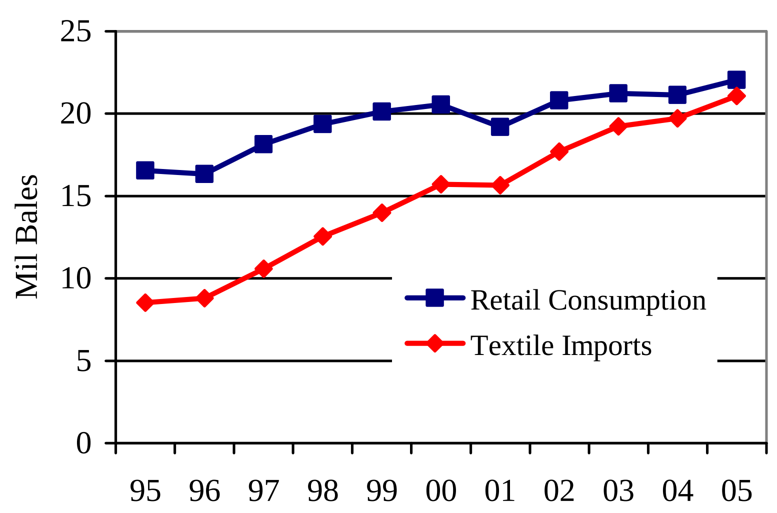
Trends in Retail Demand for Cotton Textiles & Apparel

The United States is one of the few countries that saw an increase in per-capita retail consumption of cotton between 1990 and 2003 and is the only country in which cotton increased its share of the total retail fiber market. The average consumer in the United States buys more cotton textile and apparel products than any other consumer in the world. In 1990, the average per-capita retail consumption of cotton products in the U.S. was 23.4 pounds. By 2003, the number had grown to 35 pounds per capita.

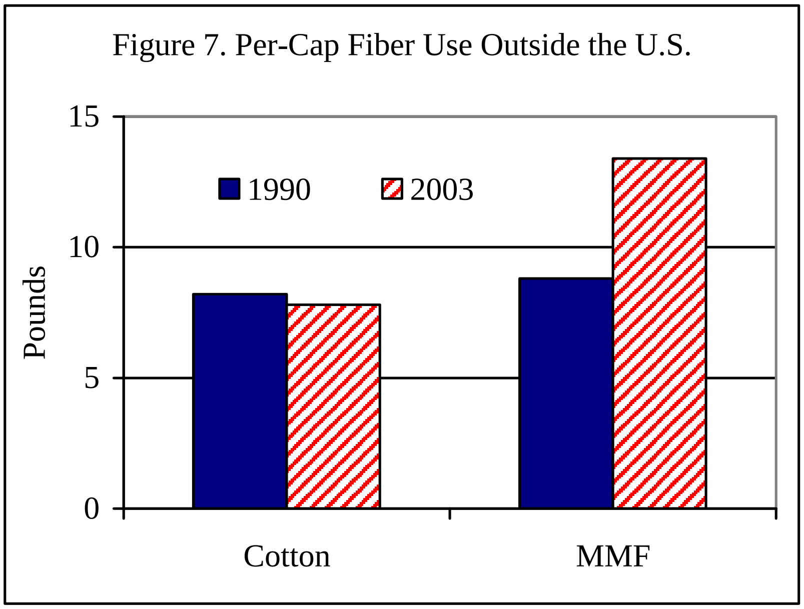
Growing cotton consumption in the United States did not happen by accident. The United States has a mature, longstanding research and promotion program that has put cotton at the top of the consumer's choices. That program is funded by U.S. cotton producers and by assessments on the cotton content of imported cotton textile products. The existing and growing U.S. market for cotton textiles is the direct result of an aggressive U.S. research and promotion campaign, which is also the direct result of a fundamental commitment to sound cotton and agricultural policy in the United States.

For 2005, NCC economists estimate that U.S. consumers will purchase cotton textile and apparel products that are equivalent to 22.1 million bales of fiber. Unfortunately, the growth in retail sales has not translated into prosperity for the U.S. textile industry. As noted earlier, the decline in U.S. mill use is a direct result of the surge in imported textile products. In this first year of no quotas, imports are expected to reach 21.1 million bales (Figure 6).

Figure 6. U.S. Cotton Retail Consumption



While U.S. consumers have been increasing purchases of cotton products, the same can not be said for consumers outside of the United States. In 1990, consumers outside of the United States used 8.2 pounds of cotton per person (Figure 7). This compares to 23.4 pounds per person in the U.S. Between 1990 and 2003, U.S. consumers increased their cotton purchases while cotton consumption outside of the U.S. fell. Even of more concern is the fact that over the same period, per-capita consumption of manmade fiber products outside of the U.S. increased by 52 percent, clearly at the expense of cotton.



In China, the consumption of cotton products fell from 6.9 pounds per capita in 1990 to 5.3 pounds per capita in 2003. At the same time, the purchases of synthetic fiber products grew from 5.3 pounds per capita to 18.4 pounds per capita. If China had maintained its per-capita cotton consumption at the 1990 level, the 1.2 billion consumers in China would be purchasing an additional 4.4 million bales of cotton per year.

Although Japan's per-capita income is above the US, its cotton consumption is only one-half the level of the US. Per capita consumption of cotton products in Western Europe is 19 pounds less than in the US. If consumers in Japan and Western Europe consumed at the same level as in the US, it would mean an additional demand of 20 million bales.

Competition from Manmade Fibers

Increased competition from synthetic fiber remains the primary reason behind the persistent weakness in world cotton demand. This is true even though the consumption of cotton is at an all-time high and has steadily expanded since 1998. However, the underlying strength of demand cannot be measured by simply looking at final consumption numbers. The strength of cotton demand must be analyzed by examining the underlying drivers such as price, income, population, and cotton's position in the total fiber market.

With the exception of the U.S., where industry self-help measures have expanded consumption, cotton has steadily lost ground to synthetic fibers since 1990. With consumption in excess of the equivalent of 170 million bales, synthetic fiber is challenging cotton in every market (Figure 8). While cotton consumption struggled with growth of less than 1.5 percent during the 1990s and early 2000s, synthetic fiber enjoyed growth of almost five percent per year.

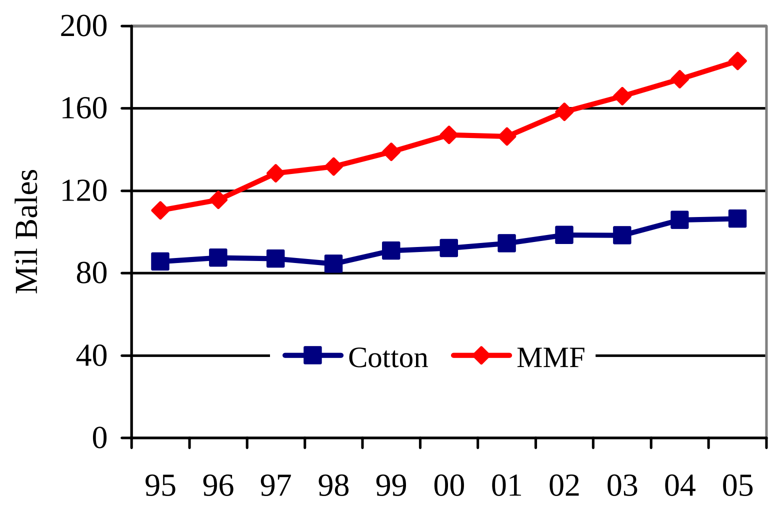


Figure 8. World Fiber Mill Use

Even more striking is the double-digit growth rates for synthetic fiber seen in China, India and other parts of Asia. Some of this growth has been spurred by incentives for the establishment of chemical fiber production. Tax waivers, rebates on import duties, elimination of income and sales taxes, and assurances of energy supplies were common incentives.

With synthetic fiber production capacity expanding faster than global demand, prices fell, stimulating market share gains against cotton and depressing cotton prices. The world's capacity to produce chemical fiber grew by almost nine percent annually during the 1990s. In China, the growth was double that rate, at an astounding 18 percent. In fact, between 1993 and 2002 the countries of Asia added more capacity for the production of chemical fiber than existed in the world in 1990.

Summary of the Economic Climate

Over the past 18 months, growers have witnessed extreme price movements. Price moved sharply higher in the fall of 2003 only to give back all of the gains as 2004 progressed. In addition to uncertainties in the marketplace, there are a number of policy challenges confronting the cotton industry. The shrinkage of the domestic textile industry has not stopped. Increasing imports over the past several years have devastated the U.S. textile and apparel industries. With the elimination of quotas, tariffs provide the only protection against surging imports. The Council will continue to monitor developments on the trade front, working for new agreements that are beneficial to U.S. cotton and textiles. In addition, appropriate enforcement of existing agreements, such as the use of textile safeguard measures, remains a priority.

The decline in domestic mill use has transformed the U.S. cotton industry more toward an export orientation, where success depends on competitiveness and market access. Competitiveness entails both price and quality. The U.S. industry must produce fiber that has the characteristics demanded by international buyers. In addition, U.S. fiber must be delivered at a price that is competitive with foreign growths and synthetic fiber. The marketing loan and Step 2 payments will continue to be essential tools for the U.S. industry. NCC continues to push for increased access into international markets. This is particularly true with China. Under China's WTO accession agreement, a tariff-rate quota was agreed to for cotton imports. However, a portion of the quota has been allocated on the condition that textile products manufactured from the imported fiber are subsequently exported on the world market. These fiber imports have been referred to as a processing-trade category and are inconsistent with China's commitments. While there may be some progress in their implementation of import quotas, it appears that the processing trade category still exists and that it can still become an impediment to U.S. cotton exports.

Key Policy Issues

The 2002 Farm Bill

The Council strongly supported passage of the 2002 Farm Bill, and at the halfway point, the legislation is a resounding success. The legislation remains vital to the structure and stability of the U.S. cotton industry and U.S. agriculture as a whole.

It is important to correct a misconception propagated by the popular press. Contrary to what many claim, the farm bill is not a lavish handout to farmers. In fact, it has become a very responsible entitlement with an enviable track record on spending. To date, budget outlays are much lower than projected by the Congressional Budget Office (CBO) during the farm bill debate. For the FY02-04 period, total spending will be approximately $16 billion less than originally projected. The counter-cyclical payment provisions of the farm bill assure that spending will decline as market prices recover.

The decoupled direct and counter-cyclical payments provide an effective financial safety net with minimal impacts on overall production and prices. Counter-cyclical payments have addressed one of the major shortcomings of the previous farm bill by providing additional support in times of low prices. In the case of cotton, the first two crops covered by this bill provide dramatic examples of the performance of the counter-cyclical payments. Low prices for the 2002 crop put the counter-cyclical payment at its maximum of 13.73 cents. As prices strengthened for the '03 marketing year, the counter-cyclical payment fell to 3.93 cents.

Also, the decoupled nature of support allows for market signals to play a prominent role in acreage decisions. The planting flexibility that began with the FAIR Act and continues under the current farm bill remains a positive with growers. In general, farmers can adjust their planting decisions based on economic signals and agronomic goals without jeopardizing the basis for program support. Over the past few years, relative market price expectations have been the single largest factor determining year-to-year changes in U.S. cotton acreage.

One of the key features of the current farm bill was the ability to update base acreages and yields for the purpose of determining decoupled payments. This has been an important feature for our members because it gave growers the opportunity for base acreage to more accurately reflect recent planting history. Obviously, the process of base and yield updates was a significant and complex undertaking for many growers, particularly in the instances where multiple landlords were involved. We commend USDA on its diligent efforts to assist growers and for providing decisions tools to facilitate the process.

During the debate of the ’02 legislation, an equitable balance was achieved between funding for commodity, conservation and nutrition programs. The bill authorized a 77 percent increase in spending on conservation programs and introduced new programs such as the Conservation Security Program (CSP). We support maintaining this balance to the extent possible.

Payment Limits

The National Cotton Council has always opposed payment limits and worked in the farm bill debate to keep any restrictions on benefit eligibility as reasonable as possible. The 2002 farm bill includes limitations for each element of the new program – direct payment, counter-cyclical payment, and marketing loan gain/loan deficiency payment. The limit for each category applies cumulatively to all program crops on the farm – cotton, grains and oilseeds. Peanuts have a separate limitation since the program is new. Effective with the 2003 crop a new adjusted gross income means test denies eligibility for participants with substantial non-farm income. Current limitations are WTO compliant. No producer is eligible for more benefits than the farm unit is entitled.

Due to the contentious nature of payment limits, the 2002 farm bill created a 10-member Payment Limit Commission, which issued its report in August, 2003 on the impact of more restrictive payment limitations. The NCC agrees with the conclusion of the panel’s report that more restrictive payment limits would have a negative effect on US agriculture and cause instability in that sector’s production, financing and marketing segments. The Commission’s report included a recommendation that any substantial changes should not take place until the next farm bill is written. At a June 17, 2003 public workshop, cotton, corn and rice witnesses all presented testimony against further limit restrictions. No producers argued for more restrictive limits.

Most farming operations must secure financing for annual production costs as well as incur long-term debt for equipment and land – changes in limitation and eligibility make financing even more difficult to obtain. Changes in eligibility rules will likely force changes in rental contracts. Current regulations require recipients of farm program benefits to be “actively engaged in farming.” Changes in these rules could have the consequence of forcing landlords to cash rent rather than share rent land – a change that would adversely affect beginning farmers and small operators who are normally unable to obtain production financing on cash rent operations.

Changes in limitations likely would result in a production shift to certain commodities. Farmers affected by additional limitations would be forced to alter cropping patterns to produce specialty crops or crops with lower cost of production. In the Mid-South, acreage would shift to production of soybeans or corn because the proposed limits would cover more acres of crops with significantly lower cost of production than cotton and rice. Conversely, acreage in the western states would probably shift to specialty or hay crops, which are not subject to limitations. In many cases a few additional acres of specialty or hay crops can undermine prices by upsetting the balance between supply and demand.

As a final point, more restrictive payment limits do not appear to provide any progress towards compliance in the ongoing WTO dispute with Brazil regarding domestic support for U.S. cotton.

Brazil's Challenge of the U.S. Cotton Program

On March 3, the appellate body upheld virtually all of the rulings of the dispute settlement panel in Brazil's challenge of the U.S. cotton program and the export credit guarantee program. The main components of the ruling are summarized as follows:

- The Panel found that the "Peace Clause" in the WTO Agreement on Agriculture did not exempt the cotton program from the Brazil challenge. In so doing, the Panel determined that the United States could not classify the direct payment program as a "green box" program.
- The Panel determined that the aggregate impact of the U.S. marketing loan, counter-cyclical and step 2 programs during 1999-2002 caused serious prejudice to Brazil and therefore violated U.S. obligations under the WTO agreements. However, the Panel did not specify the extent or magnitude of the price suppression that was deemed to cause serious prejudice.
- The Panel determined that the Step 2 program (cotton) and the export credit guarantee program (cotton and other commodities) were prohibited subsidies under the WTO and called on the U.S. to correct these measures by July 1, 2005.
- The Panel found that the direct payment program and crop insurance programs did not harm Brazil's interests.

The Council is disappointed with the ruling by the WTO appellate body. It is the opinion of the Council that several aspects of the findings are inconsistent with the intent of the Agriculture Agreement and are inconsistent with long-standing interpretations of that agreement.

Even though the Council disagrees with the decision, the U.S. cotton industry values a rules-based international trading system. While no immediate changes in the U.S. cotton program are anticipated, the Council will work with Congress and the Administration to formulate an appropriate response to this decision.

Negotiations in the WTO Doha Round

In July 2004, the Doha Round of WTO negotiations was resuscitated as participating countries reached agreement on a Framework document designed to provide the parameters that will govern the remainder of the negotiations. U.S. negotiators believe the so-called "Framework Text" can lead to a successful completion of the Doha negotiations.

The Framework outlines the following objectives to be achieved through the continuing negotiations:

- the elimination of export subsidies;
- reductions in overall levels of domestic support, with certain product specific caps;

- a redefinition of the blue box category of agricultural support, reflecting a U.S. effort to ensure the counter-cyclical program fits in that category;
- countries providing the most amount of trade-distorting support are supposed to make the largest cuts;
- significant improvements in market access commitments with exceptions for sensitive products and special products; and
- developing countries are to receive special and differential treatment.

In a move that sends the wrong message to the other members of the WTO, the Framework contains four separate references to cotton and raises concerns that cotton may receive unequal and inappropriate treatment. These references are a direct result of proposals tabled by several African cotton-producing countries to eliminate all subsidies for cotton production. This effort has been enhanced by the efforts of several international non-profit organizations - primarily OXFAM International. The discrete references remain troubling for the industry and envisage a separate set of discussions regarding cotton, but also signal a movement back into the agriculture committee for cotton discussions -- a positive step. As a result of this language, a special cotton subcommittee of the Committee on Agricultural Negotiations has been established. Its membership is open to all members and Tim Groser (the Chairman of the overall Agricultural Round) is its Chairman.

The Council has met with senior USTR officials concerning the special subcommittee's charge and the timetable for further WTO talks. In recent discussions with WTO officials in Geneva, the Council has reminded them that the cotton subcommittee authorized in the framework text is a monitoring body and not a vehicle for negotiations.

Overall, the Doha framework agreement seems to contain sufficient structural flexibility to maintain an effective farm program, but U.S. negotiators must ensure that any domestic support reductions beyond the initial year continue to move global subsidies toward harmonization and are not unfair to U.S. agriculture. The Council supports a comprehensive agreement that involves all member countries and all commodities and does not single out the U.S. cotton program. Furthermore, the experience of the Brazil case underscores the importance of specific language that will protect a country from challenges to their domestic programs if they abide by their commitments under the agreement.

Interaction with West African Countries

The National Cotton Council continues to respond to misguided allegations that the U.S. cotton program has a negative impact on West African cotton producing countries.

Since January 2004, Council leadership have made three trips to West Africa to open a dialogue with African countries (primarily Burkina Faso, Mali, Chad and Benin) that are struggling to produce cotton efficiently and profitably, given the dramatic changes that have occurred in world cotton markets. The Council is conducting this effort in coordination with the Department of Agriculture and the U.S. Agency for International Development (USAID). The Council helped host a delegation from these countries and has participated in informational exchanges and educational programs focusing on technological enhancements that could be available for cotton producers in these countries. The Council is working with U.S. agencies to develop appropriate projects to enable the West African cotton system to be more efficient, more profitable, and healthier.

As this process continues, a controversy may develop with respect to the provisions of the so-called Bumpers Amendment which limits support the U.S. government can provide to countries that are growing “surplus” commodities. The Council has discussed this issue with the Administration and has indicated it is willing to work with USDA in this area.

In early February 2005, during a trip to meet with WTO officials in Geneva, Council leaders met with representatives of several West African countries to emphasize our support for continued cooperative efforts and to caution against attacks on the U.S. cotton program. We believe that these outreach efforts will pay dividends to both U.S. cotton and our West African counterparts as we enter the next round of WTO agricultural negotiations.

China’s Implementation of Tariff Rate Quotas (TRQ)
No single country has more of an impact on the world cotton market than China. It is no exaggeration to state that China drives the world cotton market and the world's apparel market.

China is expected to import approximately 9.0 million bales of cotton from around the world in the 2004/05 marketing year, while increasing its own cotton production by 30 percent, or 6.7 million bales. Mill consumption of cotton in China continues to increase every year rising to 37.5 million bales in the 2004/05 marketing year. The expanded cotton consumption has led to dramatic expansion in apparel production as China moves to dominate world trade in apparel.

With significant imports and expanded tariff rate quotas, China's implementation of the cotton fiber TRQ was not a priority issue in 2004, although the Council remains concerned with China's refusal to eliminate the so-called "processing" trade which requires that certain quantities of cotton imports be exported as cotton apparel. As 2004 developed, falling international prices led to increased concerns regarding defaults on existing contracts with China companies. China's 2004 cotton crop is estimated at 29.0 million bales. The Council continues to monitor new phytosanitary rules issued by China to ensure these rules do not unduly restrict U.S. cotton fiber exports.

China’s Adoption of Classing Standards
Council staff participated with USDA-AMS Cotton Division staff and representatives of Cotton, Incorporated in a technical delegation that met with China Fiber Inspection Bureau officials in Beijing. The delegation’s objective was to learn more about China’s Cotton Classification Reform plan and to encourage use of standards that will facilitate U.S. cotton exports. China’s plan for reform of its cotton grading system is expected to be complete by 2010. The basis of the proposed classification system will be instrument classification similar to the United States.

Textile Quota Elimination and Textile Safeguards
The January 1, 2005, date for lifting worldwide textile quotas has passed. The U.S. textile industry focused its attention on the impact that China would have on U.S. textile production and the production of apparel by other countries that have traditionally supplied the U.S. market. An initiative that began with a March 2004 Istanbul meeting of officials from ATMI, AMTAC and

the Istanbul Textile and Apparel Exporters Association (ITKIB) has, in the ensuing months, resulted in the formation of the Global Alliance for Fair Textile Trade (GAFTT). GAFTT, now comprised of some 98 organizations from 51 countries, called for a special meeting of the WTO to consider the impact of textile quota phase-out scheduled for January 1, 2005. NCC is among the 98 participating organizations. A formal request for the meeting was filed by Mauritius, and the request was subsequently supported by a number of other countries. While the Director General of the WTO denied the request, but he did note that the scheduled quota phase-out had become a major issue that needed to be addressed.

Closer to home, a coalition of textile interests, including the National Council of Textile Organizations and the American Manufacturing Trade Action Coalition, and supported by the National Cotton Council, developed 12 petitions requesting relief under the textile specific safeguard provision in the U.S. - China WTO accession agreement. Nine of those requests asserted that imports from China would increase when quotas are removed in January 2005 and threatened the U.S. with market disruption in the specific product categories covered by the petitions. The other three petitions were reapplication petitions seeking the reinstitution of safeguards already applied to three categories of imports. The Committee for the Implementation of Textile Agreements (CITA) is authorized to limit imports from China of the specific category to a 7.5 percent growth rate if it determines those imports cause or threaten to cause market disruption in the U.S. textile market. CITA accepted most of the petitions for investigation and was expected to make a final decision regarding import relief in January or February of 2005.

However, trade associations representing apparel importers and apparel retailers filed suit in the U.S. Court of International Trade in December. The importers' associations sought, and obtained, a preliminary injunction preventing CITA from continuing its investigation under the China Textile safeguard provisions. Four U.S. textile mills filed an amicus brief opposing the granting of a preliminary injunction. The U.S. Justice Department filed arguments with the US Court of Appeals stating that the preliminary injunction preventing investigation of threat-based textile safeguard petitions was “unprecedented” and based on an erroneous standard for irreparable harm.

While the government had requested an expedited hearing on its appeal, oral arguments were initially set for May. However, the government also requested a stay of the preliminary injunction while the Court of Appeals reviews the legal arguments. Should the Court of Appeals stay the lower court’s injunction, CITA will be able to continue its investigation of safeguard petitions filed by US textile associations.

Finally, U.S. cotton and textile interests have asked CITA to establish a monitoring system concerning textile and apparel imports. Such a system would better enable the U.S. government to respond to market disruption shortly after it begins to be a issue.

Central America Free Trade Agreement
In the spring, Congress will likely take up the legislation necessary to implement CAFTA. The Council believes a good Central American Free Trade Agreement is essential to preserving a viable U.S. cotton and textile industry. Currently, almost 70 percent of U.S. domestic mill

consumption, in yarn and fabrics, is shipped to Central America or Mexico for cut-and-sew operations and the end product returned to the U.S. retail market. Potentially, a good CAFTA offers benefits to the U.S. cotton industry that could extend beyond those accompanying the Caribbean Basin Trade Preferences Act.

Last year, the Council worked to obtain favorable textile provisions in CAFTA. However, the CAFTA agreement that will be presented to Congress contains several provisions granting benefits to non-signatory countries. Discussions with industry leaders during the Council's annual meeting led to an agreement that could allow the Council to support the CAFTA agreement if benefits to all industry segments are achieved through effective implementation of the agreement and with the continued cooperation of the Administration on the Council's other trade priorities.

Other Trade Agreements
The Council was also involved with a host of separate trade negotiations being carried out by U.S. Trade Ambassador Robert Zoellick, including free trade negotiations with Australia, Bahrain, Morocco, Thailand, the Andean countries, South America, South Africa and Panama.

Free trade agreements were completed with Australia, Bahrain, and Morocco. While the Council supported the Australia agreement and generally encouraged free trade negotiations with countries in the western hemisphere, it has significant objections to provisions in the agreements with Bahrain and Morocco which circumvented the traditionally applicable rule-of-origin for textiles produced in the partnering country. The exceptions included in the agreement threatened to more than offset any potential benefit to the U.S. textile industry.

In addition, Congress completed action to extend AGOA legislation from its planned 2008 expiration date to 2015, and President Bush signed implementing legislation on July 13, 2004. This legislation also contained troubling exceptions to traditional rules-of-origin that could, ultimately, harm the U.S. textile industry.

The Council also called Congress' attention to its significant concerns with legislation that would have made Haiti a platform for Asian countries to use to undercut the U.S. textile and apparel industries.

Trade Programs
The Market Access Program (MAP) and the Foreign Market Development (FMD) Program continue to be critical components of an effective cotton trade policy. The combined investment of private ($17.7 million in 2004) and public funds ($13.6 million in 2004), coupled with industry marketing expertise, result in innovative, forward-looking programs that leverage money into high impact campaigns and promotional efforts. The impacts of these programs have been clearly demonstrated in the increased exports of cotton fiber and U.S. cotton yarn and fabric. We must continue to support and fully fund crucial U.S. export promotion programs if we are to compete effectively in today's global marketplace.

Boll Weevil and Pink Bollworm Eradication Programs

Significant progress is being made in the active eradication program area with large portions of Mississippi, Louisiana, Arkansas, West Texas, and Oklahoma with weevil numbers very near eradication levels. Approximately 6 million acres in Virginia, North Carolina, South Carolina, Georgia, Florida, Alabama, Kansas, Arizona and California have been declared weevil-free. The program continues to produce documented economic and environmental benefits. Adequate Federal cost-share funds are critical to timely completion, especially since eradication is within sight.

The entire US cotton acreage will be under eradication since the last two remaining areas in Texas (Northern Blacklands and Lower Rio Grande Valley) passed referenda to begin operations this fall. This will minimize and soon eliminate the economic impact of weevils migrating out of the non-participating zones into adjacent zones with near eradication levels of weevils. Mexico has now initiated eradication programs in cotton areas along the US/Mexico border. APHIS should be directed to make every effort to minimize overhead and administrative expenses for boll weevil eradication to ensure maximum funding reaches field operations.

The pink bollworm is costing U.S. cotton producers over $32 million each year in prevention, control costs and yield losses. Additionally, a recent occurrence of pink bollworm in a portion of the Texas High Plains resulted in an estimated $15 million dollar loss to producers in 2004. To eliminate this annual burden, the industry began Phase I of a program to eradicate this key cotton pest in 2002.

Pink bollworm eradication program is to be implemented in phases to eliminate pink bollworm as a cotton pest in Texas, New Mexico, Arizona, California and adjacent cotton areas in Northern Mexico. Mexico is now a full partner in the eradication effort. The funds requested for FY06 will enable the Phoenix Pink Bollworm Rearing Facility to rear and release up to 30 million moths sterile pink bollworm moths per day to supply the SJV program as well as Phase I of the Pink Bollworm Eradication Program in Far West Texas, New Mexico, Mexico and Arizona if necessary. Growers in the SJV, through a self-assessment, provide a significant portion of costs to conduct a containment program that has protected the SVJ from Pink Bollworm establishment for over 30 years. The Phoenix Pink Bollworm Rearing Facility (PBRF) is a partnership between the California growers and APHIS. Management, equipment, methods and partial support for the Phoenix rearing and operations are furnished by APHIS. The cost share is essential to fund APHIS expertise and operational coordination in mass rearing and daily area-wide aerial releases of millions of moths.