**TESTIMONY**
**Presented to the**
**General Farm Commodities and Risk Management Subcommittee**
**Committee on Agriculture**
**U.S. House of Representatives**
**by**
**Shane Stephens**
**Vice Chairman**
**National Cotton Council**
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I would like to thank Chairman Crawford, Ranking Member Walz, and Members of the Subcommittee for the opportunity to present the views of the National Cotton Council regarding the current economic situation in the U.S. cotton industry. My name is Shane Stephens, and I am the Vice President of Cotton Services and Warehousing for Staplcotn Cooperative in Greenwood, Mississippi. I currently serve as Vice Chairman of the National Cotton Council.

The National Cotton Council (NCC) is the central organization of the United States cotton industry. Its members include producers, ginners, merchants, cooperatives, warehousers, textile manufacturers and cottonseed processors and merchandisers. Cotton's scope and economic impact extend well beyond the approximately 19 thousand farmers that plant between 8 and 12 million acres of cotton each year. Taking into account diversified cropping patterns, cotton farmers annually cultivate more than 30 million acres of land. Processors and distributors of cotton fiber and downstream manufacturers of cotton apparel and home furnishings are located in virtually every state. Nationally, farms and businesses directly involved in the production, distribution and processing of cotton employ almost 200,000 workers and produce direct business revenue of more than $27 billion. Accounting for the ripple effect of cotton through the broader economy, direct and indirect employment surpasses 420,000 workers with economic activity well in excess of $100 billion.

Cotton is a cornerstone of the rural economy in the 17 cotton-producing states stretching from Virginia to California. Unfortunately, the current economic situation is chipping away at that cornerstone and threatening to cause long-term and potentially irreversible damage to the industry and the associated infrastructure. In response to weaker price conditions for cotton relative to competing crops, U.S. producers responded with plantings of just 8.5 million acres of cotton in 2015 (based on the November 2015 NASS estimates). Acreage is down in all regions, and the U.S. total is the lowest since 1983, which was a year when acreage was sharply reduced by government programs that encouraged land idling.

Losses in cotton area translate into pressure on associated businesses, infrastructure and rural economies. For example, USDA reports that only 601 gins operated in 2014, down 33% over the

past decade. Researchers at Louisiana State University[1] have affirmed the multiplier effects on rural economies when cotton acreage declines. A thriving cotton economy is critical to the success of many local economies.

As the 2015 harvest winds down, cotton futures prices trading in the low to mid 60 cent range are at the lowest levels since 2009. Concerns about world demand, burdensome global stocks, a stronger U.S. dollar and general price pressure in commodity markets are playing a factor in the current price environment. The effects of these factors are evident in the latest estimates of cotton production and use.

To understand the challenges facing cotton farmers, it is important to review the dynamics at work in global cotton demand. USDA estimates world mill use at 111.6 million bales for the current 2015 marketing year. The estimate represents an increase of approximately 1% from 2014 mill use, and mill use is expected to exceed world production for the first time in six years. However, even with very modest growth, world cotton demand remains almost 13 million bales below the peak demand observed in 2006. Slumping demand is largely the result of the tremendous increase in polyester use. During the 2006-2015 period when cotton mill use fell by 13 million bales, polyester's production capacity, primarily located in China, increased by 145 million bales. Excess production capacity, in many cases fueled by government support, is contributing to polyester prices in Asian markets below 50 cents per pound. While consumers continue to express their preference for cotton products, the tremendous increase in low-priced polyester production has created extraordinary hurdles for increasing cotton demand.

For cotton farmers, the prospect of higher cotton prices is further challenged by a world stocks-to-use ratio that exceeded 100% in the 2014 marketing year. Current stocks-to-use ratios stand in stark contrast to historical stocks that generally ranged between 50 and 60 percent of total use. The recent increase in stocks was the direct result of policies in place in China for the 2011 through 2013 crops. During those years, China supported its cotton farmers by purchasing vast amounts of its production into government reserves at prices well above the world market. With most domestic production locked in reserves, China imported annually between 14 and 24 million bales from the world market.

A number of significant outcomes resulted from China's policy of building reserves. First, purchasing the majority of the domestic crop at the support level essentially established a floor on internal cotton prices. By late 2011, China's cotton prices were well above international cotton prices and also well above polyester prices. China's mill use of cotton suffered as a result of uncompetitive prices. China's cotton area was generally stable between 12 and 14 million acres.

However, it became clear that continually building stocks was not a long-term solution. After three years of amassing more than 50 million bales of cotton in government reserves, China instituted a target price program for the 2014 crop at a level of roughly $1.45 per pound. The new

[1] http://ageconsearch.umn.edu/bitstream/46823/1/Fannin_Paxton_Valco_SAEA_2009_sub_ver.pdf.

target price program was applicable to the western province of Xinjiang, while the remaining cotton-producing provinces received a direct subsidy of $0.15 per pound. The target price program was continued for the 2015 crop, although the target price was reduced by 3.5% when measured in local currency. The announced target price equated to approximately $1.40 per pound based on exchange rates prevailing at planting time. In another change from the 2014 crop, no direct support was announced for the eastern provinces. As a result, cotton area in those provinces has sharply declined.

China is not the only country to support cotton production with government programs. Recent testimony[2] presented by the National Cotton Council to the House Agriculture Committee provides a more exhaustive review of policies in place in other countries. With one out of every four bales of the global cotton crop now produced in India, their government programs can have a significant impact on the world market. The Cotton Corporation of India, a government-run procurement and distribution company, is responsible for administering the price support program. The Minimum Support Price (MSP) is announced by the government each year. Between 2010 and 2015, the MSP for medium staple cotton increased by 52%, while the MSP for long staple cotton increased by 42%. The MSP is announced on the basis of seed cotton. Converting to a lint-equivalent basis requires an assumption about turn-out rates when the cotton is ginned. Assuming gin turn-out rates between 35% and 40%, current minimum prices in India equate to between $0.70 and $0.80 per pound.

While U.S. cotton policy is a focal point in international circles, there are ample studies and reports that document the various forms of government support present in most cotton-producing countries. While U.S. support for cotton has been declining in recent years, government intervention in other countries has been increasing. With reduced support in the 2014 Farm Bill, U.S. cotton farmers are competing with cotton producers in other countries that are benefitting from higher support levels. Two recent reports illustrate the comparative support rates across selected cotton producing countries. In June 2015 testimony to the House Agriculture Committee, Dr. Darren Hudson with Texas Tech University noted that the marketing loan in the United States was below support prices in China, India, Pakistan, Brazil and Uzbekistan.[3]

In a November 2014 report[4], the International Cotton Advisory Committee (ICAC) reported that average direct assistance to cotton production across all countries was $0.26 per pound. For the United States, ICAC estimated the average support at $0.07 per pound. Direct assistance to U.S. cotton producers was well below levels provided in other countries. It should be noted that the ICAC study was based on the 2013 crop year, which was the final year before the significant changes implemented by the new farm legislation.

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[2] http://agriculture.house.gov/uploadedfiles/10.21.15_adams_testimony.pdf

[3] http://agriculture.house.gov/uploadedfiles/hudson_testimony.pdf

[4] International Cotton Advisory Committee. *Production and Trade Policies Affecting the Cotton Industry*. November 2014. Washington DC.

The studies underscore the challenging conditions facing U.S. producers with international cotton production supported at a level almost four times the level of support in the United States. Unfortunately, current proposals submitted within the World Trade Organization (WTO) would lead to a further imbalance in the situation. The U.S. cotton industry is steadfastly opposed to any proposals considered in the lead-up to or during the December WTO Ministerial that further commits the U.S. to additional changes in cotton policy. I encourage this Committee and our negotiators to hold firmly to the position that agricultural markets have changed since 2005, and that the U.S. cotton industry has evolved in ways that far exceed the demands of the Hong Kong Mandate. A cotton specific "solution" in the WTO negotiations is no longer necessary.

I bring these issues to the attention of the subcommittee because of the critical influence of international markets in the financial conditions of U.S. cotton farmers. In recent years, approximately 75% of U.S. production enters export channels. Policies that directly affect international production, consumption and trade have a direct bearing on U.S. market prices. Currently, the strength of the U.S. dollar is a limiting factor in exports. China, already covered in some depth, remains the largest cotton importer although they are projected to significantly reduce imports given the current balance between supply and demand. Another obstacle impeding U.S. exports is an ongoing dumping investigation conducted by the Turkish government.

In recent years, Turkey has been the second largest export customer for U.S. cotton. For the past year, Turkish authorities have been investigating U.S. cotton exporting companies to determine if U.S. cotton is being dumped into the Turkish market. An affirmative finding by Turkish officials would mean that an anti-dumping duty would be applied to U.S. cotton imports, while imports from other countries would remain duty free. A duty would undermine the competitiveness of U.S. cotton and directly impact prices received by U.S. cotton farmers. The uncertainty of the ongoing investigation is already dampening interest in U.S. cotton by Turkish mills, as current sales for this marketing year are just one-third of year-ago levels.

The Turkish government self-initiated the investigation shortly after the U.S. announced anti-dumping/countervailing duty (AD/CVD) investigations of Turkish steel pipe. The Minister of Economy was quoted in Turkish press as saying Turkey would launch three investigations for every one the US aimed at Turkish products. The document produced to support the initiation of the investigation is largely redacted, so the information upon which the allegation of dumping is based is not available for parties to rebut. Many observers believe that Turkey seeks to damage the U.S. cotton industry by using the AD investigation not to benefit their domestic industry but out of retribution for the U.S. steel cases. This is just as much in contravention of the WTO as using trade barriers out of protectionist intent.

It is against the backdrop of these challenges that 2015 U.S. exports projected at 10.2 million bales would be the lowest in 15 years. Of course, the demand base for U.S. cotton is much different than 15 years ago. When cotton exports last fell short of 10 million bales in 2000, the U.S. textile industry consumed almost 9 million bales. Unfortunately, that is no longer the case.

Between 1997 and 2008, the amount of cotton used by U.S. textile mills experienced a precipitous decline, falling from 11.3 million bales down to 3.5 million bales. Since 2008, the U.S. textile industry has stabilized, and there has even been a modest increase in cotton consumption with mill use for the current marketing year expected to reach 3.7 million bales. In recent years, the U.S. industry has benefited from new investments, and textile companies are building new spinning operations in the United States.

One factor contributing to the renewed optimism in the U.S. industry is the continued benefits of the Economic Adjustment Assistance Program (EAAP), first authorized in the 2008 Farm Bill. Recipients must agree to invest the proceeds in equipment and manufacturing plants, including construction of new facilities as well as modernization and expansion of existing facilities. EAAP funds have allowed investments in new equipment and new technology, thus allowing companies to reduce costs, increase efficiency and become more competitive against imported textile products. I would like to thank the members of this subcommittee for their work in the reauthorization of the program in the 2014 Farm Bill. The continuing support of the program allows U.S. textile mills to make the new investments necessary to remain competitive.

For the U.S. textile industry, the Export-Import (Ex-Im) Bank plays an important role in providing financing. Members of the subcommittee are likely aware of the amount of U.S. cotton production that enters export channels, but it is also the case that the majority of yarn and fabric produced by our textile manufacturers is exported. The Ex-Im Bank plays a critical role in financing exports of textile products. We commend Congress for taking steps to reauthorize the Ex-Im Bank.

A final issue to bring to your attention, particularly as it relates to the U.S. textile industry, is the Trans-Pacific Partnership (TPP) agreement. Overall, the agreement provides for equity and reciprocity for many aspects of trade in cotton fiber between the United States and the other TPP countries. With respect to cotton fiber imports into the United States, the agreement provides for elimination of import duties within 10 years. The duties and quotas applicable to U.S. cotton fiber exports to TPP countries appear to be eliminated immediately.

The cotton industry cannot evaluate any free trade agreement without consideration of the provisions of the agreement that affect trade in cotton textiles. The U.S. cotton industry has long held the concern that a TPP agreement that includes Vietnam is not positive for the U.S. textile industry. Much of the concern stems from granting additional access to the U.S. textile market to a centrally-planned economy that has textile companies with a history of contract defaults. With those overarching concerns in mind, U.S. negotiators appear to have taken steps to mitigate the negative impacts. The agreement generally contains acceptable rules of origin for textiles and limited exceptions that allow for a well-balanced outcome for all parties as well as our partners in the Western Hemisphere. However, there are special provisions with Vietnam and Malaysia that can be detrimental to the U.S. cotton industry if not appropriately implemented. Strong customs enforcement is of critical importance to ensure that the provisions of the agreement are adhered to.

The 2014 Farm Bill included a number of significant changes, not only for cotton policy, but on a more general basis. The unified payment limit that now includes marketing loan gains has been extremely burdensome to implement and created additional uncertainty for cotton producers and merchandisers. It is our hope that a reauthorization of generic certificates will provide relief from this provision.

Another issue creating challenges in the marketing of cotton is the requirement for producers to file a CCC-941 Average Adjust Gross Income (AGI) Certification and Consent to Disclosure of Tax Information form on an annual basis. The requirement for each producer to file a CCC-941 every program year has caused a major interruption in the orderly flow of marketing cotton. The overwhelming majority of producer's average adjusted gross income is less than $900,000. An alternative would be to require that filing this form be done on a one-time basis and remain in effect for the life of the farm bill. Then require the IRS to annually audit and report to FSA if the producer's AGI exceeds $900,000. Since the determination of the average AGI is performed on the 3 years preceding the previous crop year, IRS should be able to report any changes in AGI status on producers prior to any payments for the crop year. As it works today, IRS reviews every producer every year. Why make the producer re-file the same form each year? This would be a more efficient use of all involved in the process. Any assistance you can bring to alleviate the huge burden this puts on all cooperatives and marketers handling this issue will be greatly appreciated.

Mr. Chairman, the National Cotton Council sincerely appreciates the opportunity to provide an update on the economic situation of the U.S. cotton industry. With the lowest U.S. acreage in more than 30 years, the smallest exports in 15 years, and cotton prices at their lowest level since the 2009 recession, economic pressure is mounting with revenue down 34% from the average levels of 2010 to 2013. Lower revenues generated by an acre of cotton lint and cottonseed production come at a time when costs of production remain at elevated levels. The differential between costs and market revenue is the largest in the past ten years. Given the cumulative impacts of 2014 and 2015, producers are increasingly concerned about securing production financing for the 2016 crop.

We understand that commodity markets are cyclical, and low prices are the cure for low prices. However, in the current cycle, the cure may not come in time to sustain many producers and businesses reliant on cotton. Futures markets suggest that a relatively flat price situation could prevail for 2016 and 2017. Cotton prices remain pressured by global stocks in excess of 100 million bales with more than 60 million bales held by China. In the face of increased government support in other countries, the U.S. industry is requesting USDA to designate cottonseed as an 'other oilseed' for the purpose of the Price Loss Coverage (PLC) and Agriculture Risk Coverage (ARC) programs authorized in the 2014 Farm Bill.

The 2014 Farm Bill (and previous farm bills) includes statutory authority for USDA to designate 'other oilseeds' for purposes of farm bill programs. The infrastructure for the U.S. cotton industry (gins, warehouses, marketing coops and merchants, and cottonseed crushers and merchandizers) will continue to shrink unless there is a stabilizing policy for cotton to help sustain the industry in periods of low prices such as currently exists. This program will be important to ensure continued crop diversity in many parts of the Cotton Belt and the continued economic activity in rural areas.

Cotton is the only traditional 'program' crop that does not have any fixed price protection policy delivered by FSA in the 2014 Farm Bill. While this was the result of the WTO case brought by Brazil challenging U.S. cotton policies and the export credit guarantee programs from more than a decade ago, there still exists an ability and opportunity to provide support for a major co-product of cotton production – cottonseed. It is also important to remind the subcommittee that more than 80% of retaliatory authority given to Brazil was due to export credit programs.

In order to provide timely relief from current financial pressures, the Secretary is requested to implement the program as early as the 2015 crop. For the 2015 crop, streamlined implementation can be achieved by offering a producer the option to receive cottonseed PLC/ARC payments on cottonseed acres attributed to generic base without penalizing producers who made other covered commodity program planting decisions. For the 2016 crop and beyond, the U.S. cotton industry will work with the Secretary to develop comprehensive provisions of the PLC/ARC programs.

Numerous lending institutions have expressed their support for the proposal through letters to the Secretary. We understand that a letter is being circulated among members of the House, and we thank those of you who have signed the letter and encourage those who have not yet signed to please do so. The cotton industry understands the significant request represented by this proposal. Such a program does not come without an additional workload for USDA and the potential for additional spending. However, spending under a cottonseed program should be viewed in the same manner as other farm program spending, which is an investment in not only production agriculture but the rural economy. As previously noted in my testimony, the cotton industry generates annual economic activity in excess of $100 billion. Implementation of the cottonseed proposal will play a critical role in protecting that economic activity.

Thank you, and I will be happy to answer any questions at the appropriate time.