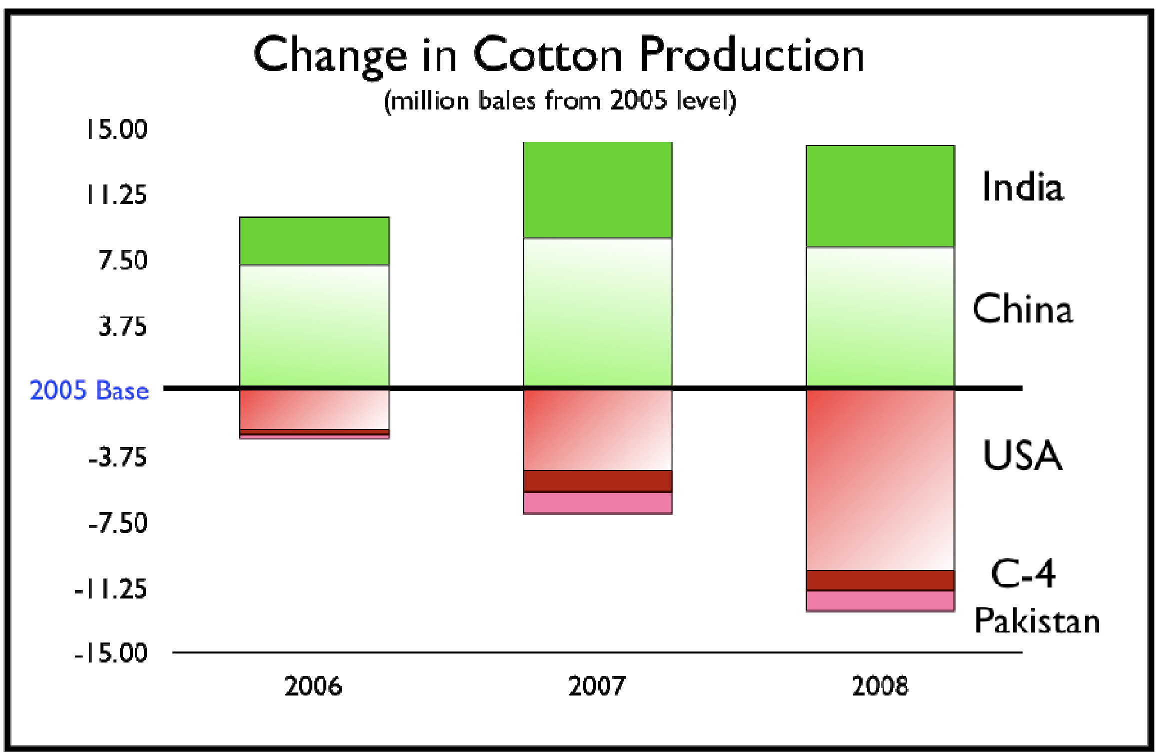
China and India Dominate and Distort World Cotton Market
November 2008

China and India are the two largest producers and processors of cotton fiber. Together, they account for more than 50% of world production, and their textile industries process more than 55% of the world's cotton. Over the past few years, these countries have increased their government's support of their cotton and textile sectors. This increased support has helped spur an increase in cotton and textile production in both countries, even as the rest of the world decreases production and mill use. (See Appendix Charts)

In China, the imposition of a variable levy, increased government purchases from the private sector, burdensome registration and licensing programs, and increases in tax rebate schemes have combined to pump **$10-12 billion** into their cotton and textile sectors annually.

Almost **$2 billion** in increased cotton price support has helped push Indian cotton production to a record level in 2008.

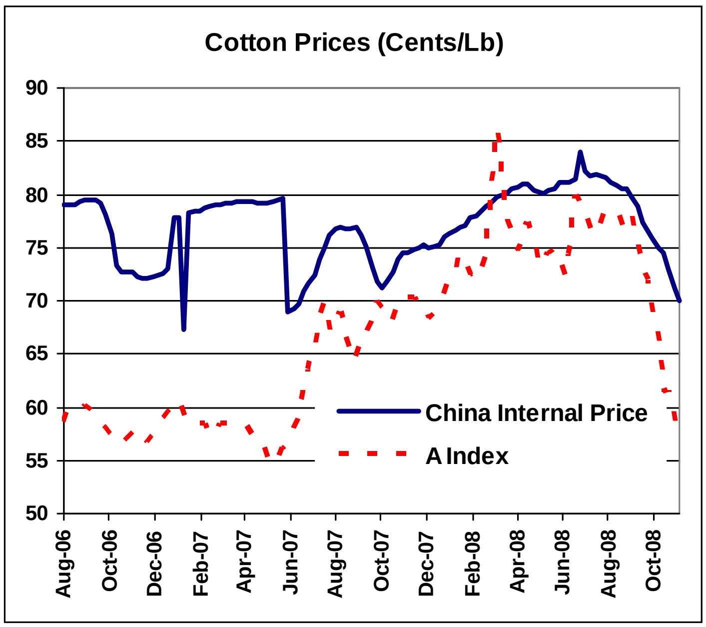
The significant growth in cotton production in these two countries has come at the direct expense of countries such as the 4 cotton-producing (C-4) African countries, Pakistan, and the United States. In fact, over the last three years, increases in cotton production in India and China almost exactly offsets decreases in cotton production in the U.S., the C-4, and Pakistan.



China Supports Internal Prices Well Above the World Market

Inadequate market access, burdensome registration requirements, numerous price support programs, tax rebates, and other schemes and the manipulation of cotton stocks by China are greatly distorting world trade in cotton and harming cotton producers in developed and developing countries. The collective impact of all of these market distortions is causing China to exercise disproportionate and negative influences on the global cotton market, reducing sales and marketing opportunities for all other cotton and cotton textile producing countries.

China has recently enacted several policy changes designed to support both cotton production and their domestic textile industry. The China National Cotton Reserves Corporation has substantially increased purchases of the 2008 harvest. Total purchases of 5.5 million bales are targeted with the goal of supporting local seed cotton prices. The purchase price equates to more than 80¢ per pound of lint (Source: *Cotton Outlook*, November 7, 2008) -- more than 25¢ higher than the average world price for cotton the week of November 7.



Limited access to quotas, coupled with a variable rate import levy, is currently supporting internal market prices in China at a level approximately 15¢ above the world prices, as measured by the A Index.

By restricting imports, China effectively provided a price support subsidy of 13.05 cents per pound on 37.0 million bales (480-lb) of Chinese domestic cotton production in 2007, resulting in an Aggregate Measure of Support (AMS) of $2.32 billion, using a price wedge analysis.

China recently announced that the General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ) will require cotton exporters to China to register with AQSIQ beginning September 15, 2008. The exporters must meet certain requirements – many of which are subject to AQSIQ's discretion. The registration must be renewed every three years. Shipments by firms not registered will be subject to highly unfavorable terms and conditions.

By supporting the internal price of cotton at levels in excess of the world market price, China conversely places its textile sector at a price disadvantage relative to textile mills that can purchase cotton at world market prices. As a result, China has taken other steps to enhance the competitiveness of its textile sector. In short, China is applying subsidy schemes that cause internal cotton prices to be high and then implementing subsidy schemes for its textile sector designed to offset those high internal prices. In a recent meeting of the State Council, the importance of the textile industry was acknowledged and indications were given that additional government support would be implemented, including additional increases in the export tax rebate, elimination of certain charges now required of the textile industry, and additional government funds for technical updates by the industry.

An increase in the export tax rebate would be the third since August 1 when the rebate was increased from 11% to 13%. On November 1, the rebate was further bumped to 14%. Textile industry groups have called for the rebate to climb to 17%. The National Council of Textile Organizations (NCTO) estimates that the result to China's textile industry is an additional $10 billion in export subsidies.

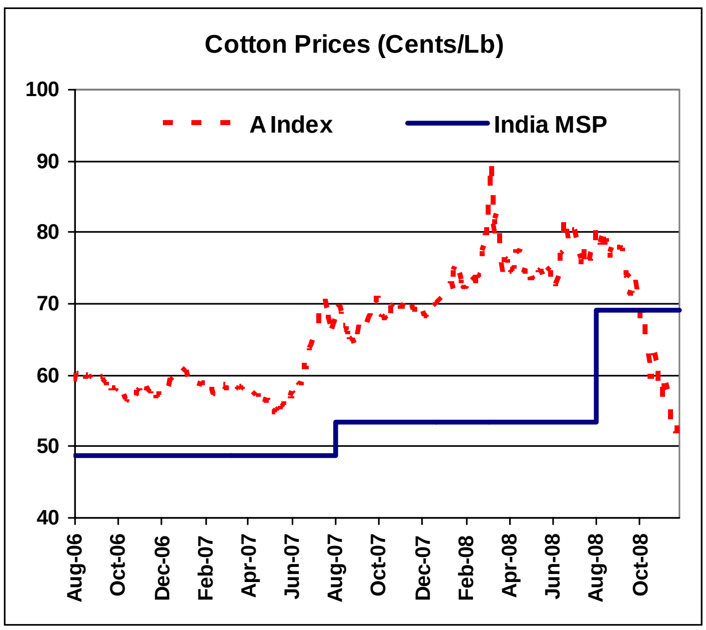
The result of China's massive expansion in textile production is evidenced by their continual increases in share of world trade, which is now approaching 30%.

India Increasing Cotton Support

To provide income support to their cotton farmers, the Government of India announces a Minimum Support Price (MSP) for seed cotton, i.e. un-ginned cotton. Whenever the market price falls below the MSP, the Cotton Corporation of India (CCI) undertakes the support price operation and purchases seed cotton at the MSP without any quantitative limit. Losses, if any, incurred on account of the support price operations are reimbursed to the CCI by the Indian government.

Prior to the start of the 2008 harvest, the Indian government announced an increase in the MSP of 40-45%, depending on the quality of the seed cotton. As the following chart shows, the average MSP equates to approximately 69¢/lb, when accounting for exchange rates and seed-to-lint conversions.

While historical support prices in India have been below the world price, the current MSP is 14 to 16¢ above the A Index. In the current marketing year, the U.S. Department of Agriculture estimates India will produce 25 million bales of cotton – a new record for production. If current price levels persist for the remainder of the 2008/09 marketing year, a conservative price wedge analysis results in an Aggregate Measure of Support to cotton of approximately $1.7 billion (25 million bales at 14¢/lb).



APPENDIX CHARTS