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Testimony of Nick McMichen

On Behalf of the National Cotton Council

before the

Committee on Agriculture, Nutrition, and Forestry

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Introduction

Chairman Roberts, Ranking Member Stabenow, and Members of the Committee, thank you for the opportunity to provide this testimony regarding the current farm bill and the policy needs of the U.S. cotton industry in the next farm bill.

My name is Nick McMichen and my family and I operate a fifth-generation diversified row crop and cattle farm in Centre, Alabama. Our crop mix consists of cotton, corn, peanuts, soybeans, and wheat. Our farm has been in production agriculture since 1842, settled via a land patent signed by President James K. Polk.

I serve as a producer delegate to the National Cotton Council (NCC) and Alabama state chairman to the American Cotton Producers. I also serve on the Southern Cotton Growers board, am an elected member of Alabama Cotton Commission, and a board member for the National Association of Wheat Growers, and Alabama Wheat and Feed Grains Committee.

In 2017, I was elected president of Area II-Alabama Association of Conservation Districts, and also serve on the Coosa Valley RC&D Council Board and chairman of Cherokee County Soil and Water Conservation District.

I am a partner in McMichen Farm and Cherokee Gin and Cotton Company.

The NCC is the central organization of the United States cotton industry. Its members include producers, ginners, merchants, cooperatives, warehouses, textile manufacturers and cottonseed processors and merchandisers. Farms and businesses directly involved in the production, distribution, and processing of cotton employ more than 125,000 workers and produce direct business revenue of more than $21 billion. Annual cotton production is valued at more than $5.5 billion at the farm gate. Accounting for the ripple effect of cotton through the broader economy, direct and indirect employment surpasses 280,000 workers with economic activity of almost $100 billion.

In addition to cotton fiber, cottonseed products are used for livestock feed, and cottonseed oil is used as an ingredient in food products as well as being a premium cooking oil.

Current Industry Conditions

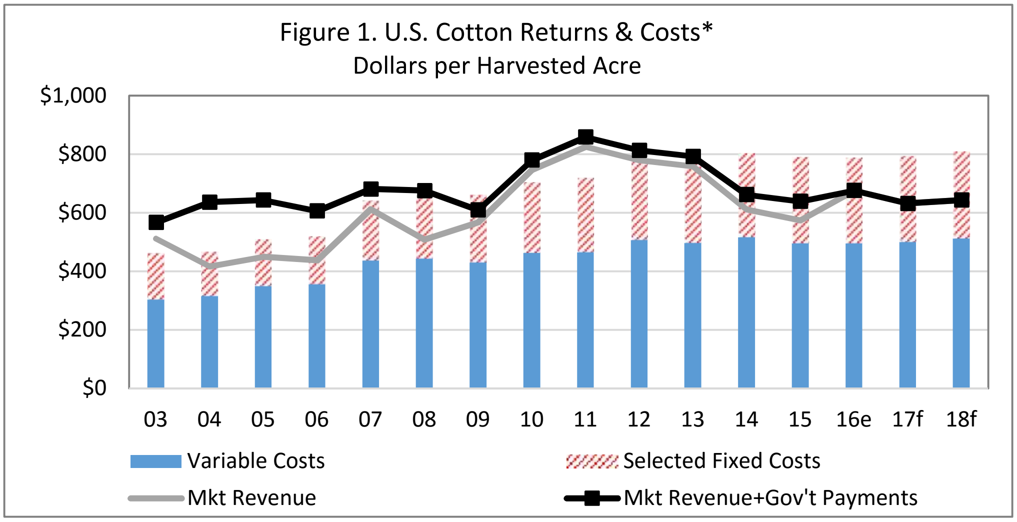
As you know, the current economic situation for much of production agriculture is bleak, including for U.S. cotton farmers. The passage of the 2014 Farm Bill coincided with significant changes in the global cotton market. Shortly after the bill was approved, cotton prices began a significant decline, the result of a build-up of global cotton stocks, especially in China, decreased demand, and reduced exports. In 2015, this led to the lowest U.S. cotton acreage in more than 30 years. While cotton prices and acreage have increased from the lows experienced in 2015, producers are still struggling with prices at levels not adequate to cover all production costs. According to USDA data, in 2016, 19 percent of cotton farms are considered either highly or extremely highly leveraged.

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 113.8 million bales for the current 2016 marketing year. However, even with very modest growth, world cotton demand remains more than 10 million bales below the peak demand observed in 2006. Slumping demand is largely the result of the tremendous increase in polyester use. During the past decade when cotton mill use fell by 10 million bales, polyester's production capacity, primarily located in China, increased by 157 million bales. Excess production capacity, in many cases fueled by government support, is contributing to polyester prices in Asian markets of approximately 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.

I highlight these issues because of the critical influence of international markets and manmade fiber on the financial conditions of U.S. cotton farmers. Policies that directly affect international production, consumption and trade have a direct bearing on U.S. market prices.

2017 cotton acres increased to 12.1 million acres, a 20% increase from 2016 and a continued recovery from the 30-year low experienced in 2015. Above-average cotton yields in some states, improved water availability and moisture conditions, and the relative economic return of cotton compared to other major row crops (i.e. corn, soybeans, wheat) are encouraging more acres in some areas.

While cotton returns have improved relative to other crops, USDA data indicate that on average, cotton market returns are generally sufficient to cover variable (or operating) costs but fall well short of total costs. Since 2014, market returns from cotton and cottonseed have fallen short of the total costs of production (variable and fixed, not including return to management and family living expenses). When accounting for the minimal Federal farm policy support provided to cotton during this period, the last three harvests have seen total costs significantly exceed total returns. These sustained losses in the current period are unlike any in recent history for U.S. cotton.



While input costs have largely leveled off in recent years, there has been little to no decline in these production expenses. Furthermore, projections by the Food and Agricultural Policy Research Institute for 2017 and 2018 call for lower cotton market revenue relative to the 2016 crop.

For the 2014-16 crops, total market revenue and governments payments for cotton averaged just 83% of the total costs depicted in Figure 1. For 2017 and 2018, the ratio of revenue + government payments to total costs falls to 80% based on FAPRI projections.

While most commodity prices have weakened over the life of the current legislation, cotton still finds itself at a disadvantage relative to the major crops covered by the Title I safety net. A weighted average of market returns + government payments for corn, soybeans, wheat, rice and peanuts stood at 99% of total costs for the years 2014-16. Under the FAPRI projections, the ratio for those crops is 98%.

Cotton Policy and the Farm Bill

The lack of eligibility for the same price and revenue policies as other crops remains a major concern for cotton. As you know, these Title I commodity policies in the farm bill are designed to help producers withstand prolonged periods of price declines and depressed market conditions. While the Agriculture Risk Coverage (ARC) and Price Loss Coverage (PLC) policies have generally performed well for producers, like myself, of other crops, I remain vulnerable to further instability in cotton markets.

Under the current farm bill, cotton producers can purchase the Stacked Income Protection Plan (STAX) crop insurance policy. In addition, the marketing loan program was modified so that the loan rate can adjust lower based on average market prices of the prior two years. Cotton is the only program crop that does not have any long-term price or revenue protection policy in the 2014 Farm Bill.

Cotton policy in the 2014 Farm Bill was enacted largely in response to a World Trade Organization (WTO) trade challenge brought by Brazil against certain components of U.S. farm policy and select cotton-specific policies. To avoid further political controversy and trade retaliation, Congress provided STAX as the core safety net for cotton. Unfortunately, given the changes in market conditions, STAX has proved inadequate for U.S. cotton producers.

The cotton industry is currently requesting that the Administration provide a bridge of economic relief for our industry until a new farm bill can be enacted. The previous Administration operated the Cotton Ginning Cost Share Program for the 2015 crop, which quite literally helped many cotton farmers stay in business. Over 1,600 agribusinesses and lenders recently wrote President Trump requesting that this program be renewed. Their call was joined by bipartisan letters that included 26 Senators and 109 Members of the House asking that the cost share program be available starting with the 2016 crop year. Several Members of the Committee cosigned that letter and our industry is extremely grateful, especially to Senator Boozman for leading the initiative.

In addition, another short-term initiative that can help bridge the industry's need for support until the next farm bill is the designation of cottonseed as a covered commodity eligible for the ARC/PLC programs. The Senate Appropriations Committee recently approved the FY 2018 Agriculture Appropriations measure that includes a provision to make cottonseed eligible for ARC/PLC beginning with the 2018 crop year. The House Appropriations Committee included report language supporting this type of policy as part of their Agriculture Appropriations bill. We are very appreciative to Chairman Cochran and others on the Appropriations Committee for their commitment to this issue and are hopeful this policy can be included in a final FY 2018 agriculture funding bill later this year. While we are counting on the Cotton Ginning Cost Share program from the Administration and the cottonseed policy so that many farmers can maintain their family farms in the interim, our industry also is looking ahead to what a viable safety net will be for cotton farmers in the next farm bill.

The NCC has begun internal discussions on the policy objectives for cotton in the next farm bill. We know that a meaningful safety net for cotton must be included in Title I of the farm bill. Better protection in times of depressed markets can take on several forms, and our industry will continue to pursue the best avenue to provide growers with adequate protection that is consistent with both our international obligations and the needs of our industry. A survey of our producer members clearly indicated that a viable, long-term Title I safety net should not rely solely on cottonseed but rather take into consideration the full value of the cotton crop.

Our industry is continuing our policy development work with the goal of providing the Agriculture Committees with detailed policy recommendations by early fall.

As the cotton industry can attest to first hand, an effective safety net for producers must consist of two key components: 1) an effective commodity policy that provides either price or revenue protection to address prolonged periods of low prices and depressed market conditions that span multiple years; and 2) a strong and fully accessible suite of crop insurance products that producers can purchase to tailor their risk management to their specific needs to address yield and price volatility within the growing season.

Marketing Loan Program

There are several other important provisions of the farm bill that are priorities for our industry. Our industry relies heavily on a properly functioning marketing loan program that helps ensure orderly marketing and flow of cotton to the market. Maintaining the marketing loan policy, with some minor adjustments, is a priority.

Crop Insurance

A strong crop insurance program is also critical since in agriculture, one thing for certain is crop losses will occur in some part of the U.S. each year. Annual losses incurred by farmers clearly demonstrate the need for crop insurance protection and the public-private partnership of program delivery. Farmers, their lenders, input suppliers and other stakeholders agree that crop insurance protection should remain a viable, affordable tool for managing risk.

Notwithstanding the relatively low participation in the STAX policy due to the weaker market prices for cotton, crop insurance as a whole, and underlying individual policies specifically, remain a critical component of the overall safety net for cotton producers. In 2016, 96% of cotton acres were covered by either multi-peril "buy-up" insurance or catastrophic coverage. 88% of these acres were covered by multi-peril insurance. The STAX policy was purchased on more than 2.5 million acres covering 26% of total insured acres. Participation in STAX has not been as extensive as initially projected, largely because of extremely low prices, which render the revenue assurance of STAX less beneficial relative to the costs of production.

For this reason, it is imperative that cotton producers have access to the same complement of risk management policies and tools as other producers, including commodity policies in Title I, along with crop insurance.

Federal crop insurance provides an effective risk management tool to farmers and ranchers of all sizes when they are facing losses beyond their control, reduces taxpayer risk exposure, makes hedging possible to help mitigate market volatility, and provides lenders with greater certainty that loans made to producers will be repaid. The public-private partnership of program delivery works very well, allowing for timely and outstanding service to producers when they need it the most and providing much-needed jobs across rural America.

While the overall crop insurance program is working well and should be defended, there are a few areas that can be improved. The NCC is currently working with the Risk Management Agency (RMA) to improve quality loss provisions that have proved inadequate for many producers in the Southeast region who suffered through extensive rains during the 2015 and 2016 harvest seasons. RMA has been a good partner in identifying and pursuing improvements to this feature of the crop insurance product. It is our understanding that an improved quality loss provision will be available for cotton crop insurance policies for the 2018 crop. Particularly important in the Southwest region is the ability to insure Enterprise Units by practice, which is permitted in the 2014 Farm Bill. In our view, RMA has not implemented this provision in the manner intended by Congress and should be reconsidered by USDA and, if necessary, further clarified in the next farm bill.

Payment Limits and Program Eligibility

Our industry is opposed to any further tightening of payment limits and eligibility requirements, as we believe these policies are already too burdensome and restrictive considering the size and scale of production agriculture necessary to be competitive and viable in today's global market. In addition, we believe the current definition of 'family member' that is used for actively engaged provisions in the farm bill should be broadened to ensure extended family members are not forced out of the family farm simply because they do not fit within the current, unnecessarily restrictive definition for 'family member'. We hope to work with the committee to address this problematic provision in the next farm bill.

Extra Long Staple Cotton Policies

There are important policy considerations for Extra Long Staple (ELS) or Pima cotton as well. The industry is evaluating the potential for an increase in the loan rate for the ELS loan program in order to better reflect the relative market value of Pima cotton. Since this is a non-recourse loan without marketing loan provisions, there should be little, if any, additional government cost or exposure. Also, the ELS Cotton Competitiveness Program is not currently functioning as intended given the recent shift in the countries that are major producers, importers and exporters of ELS cotton. For the intended objectives of this program to be met, USDA needs to take steps to update the key price data being used. If USDA continues to resist this administrative adjustment, then modifications in the next farm bill could be necessary.

Conservation Policies

Conservation programs continue to be extremely popular across the Cotton Belt. Specifically, the Environmental Quality Incentives Program and the Conservation Stewardship Program are both heavily accessed. I commend the Committee for streamlining conservation programs in the 2014 Farm Bill. This made them easier for the Natural Resources Conservation Service (NRCS) to administer, but more importantly easier for producers like myself to utilize. These programs have become integral parts of many producer's operations and achieve the goal of improving and protecting the environment while also improving our farming operations.

One area that can be improved is exempting NRCS from requiring producers participating in USDA cost share programs to obtain and keep up to date a System for Award Management (SAM) number and a Duns and Bradstreet (D-U-N-S) number. The SAM number is burdensome because of the yearly renewal requirement. The D-U-N-S number can also be complicated if the number is arbitrarily changed without the producer's knowledge. Many producers, including some in my area, have had payments extensively delayed after they had completed the project because of this paperwork requirement. In addition, many producers may not realize that while obtaining these numbers is a burdensome, time consuming process, they can obtain these numbers for free, yet inadvertently agree to pay companies who contact them directly hundreds of dollars to obtain the numbers. The SAM system and D-U-N-S requirement were never intended for conservation contracts, and it is our hope that this oversight can be corrected in the next farm bill.

Textiles and Economic Adjustment Assistance Program

After a decade of experiencing a precipitous decline in the amount of cotton used by U.S. textile mills, U.S. mill consumption has stabilized since 2008 due to ongoing assistance provided in the farm bill.

The recent years of stability and expected future growth can be attributed to 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. By allowing U.S. textile mills to make the new investments necessary to remain competitive, the program supports a manufacturing base that supports jobs in the United States. We strongly support continuation of the program in the new farm law.

Exports and Trade Promotion Programs

The U.S. cotton industry is heavily reliant on exports and open markets for U.S. cotton and cotton textile products. U.S. cotton producers, and the other six segments of the industry, operate in highly integrated and competitive global fiber and textile/apparel markets. On average, 75% of U.S. cotton production is exported as raw cotton fiber, and another 20-25% is exported as textile products (yarn, thread, fabric), so nearly 100% of U.S. production is ultimately exported in some form. The U.S. cotton industry is extremely dependent on open trade relationships with key markets. Likewise, factors in the global fiber market heavily influence the economic situation of the U.S. cotton industry.

Currently, markets are closely watching China's management of cotton stockpiles (~48 million bales) and issuance of import quotas. India's increased production and potential growing presence in the export market could weigh on markets as this year's harvest approaches. As discussed earlier, cotton continues to face growing competition from heavily-subsidized, foreign-produced manmade fiber.

Given the tremendous reliance by our industry on exports of raw cotton fiber and yarn, it is essential that the U.S. agriculture industry have a strong, well-funded public-private partnership to help leverage private resources to expand export markets and grow demand for U.S. agriculture products. A central part of this effort is USDA's Market Access Program (MAP) and Foreign Market Development (FMD) program. Even though the U.S. continues to be heavily outspent by other major agricultural producing and exporting countries, MAP and FMD investments have been flat for more than a decade. MAP and FMD have resulted in a $2.1 billion increase per year in cash farm income since 2002. Agricultural exports in 2014 accounted for $340 billion in economic output and supported 1.1 million jobs. For this reason, we believe it is justified for the new farm bill to invest additional funds in these programs.

The value of U.S. cotton fiber exports exceeds $5 billion annually, along with an additional $3 billion in exports of value-added cotton textile products. Independent studies found that for each dollar spent by organizations like Cotton Council International that partner with USDA to expand and promote exports, there is a $35 return on investment. In direct monetary and in-kind investments, the U.S. cotton industry invests over $2 for every $1 of MAP funds utilized for export promotion activities. These programs work and in response, our industry's stakeholders are investing in their businesses and creating jobs.

Credit Challenges

The availability of credit is paramount for all of agriculture, and particularly so for producers. The recent period of prolonged, depressed cotton prices has placed an extraordinary strain on the ability of many cotton producers to obtain credit. Highlighting this concern across the Cotton Belt is a recent letter signed by 1,605 agricultural lenders, lending associations, agribusinesses, and other rural businesses requesting short-term economic assistance for cotton producers through the Cotton Ginning Cost Share program. In addition, maintaining adequate funding for USDA to operate the direct and guaranteed operating and farm ownership loan programs is of critical importance to our industry.

Regulatory Burdens

The U.S. cotton industry continues to be burdened by various regulatory issues that need to be addressed to help reduce unnecessary costs. For example, in September 2015, the Food and Drug Administration (FDA) issued the *Food Safety Modernization Act Preventive Controls for Animal Food Rule*, in which the preamble excluded all cotton gins from the Current Good Manufacturing Practices (CGMP) requirement. Yet the rule creates a distinction between gins that are **not** considered farmer-owned under the rule and those that are considered farmer-owned. The non-farmer-owned gins, according to FDA definition, would be subject to the rule's hazard analysis and preventative controls requirements. Because of the type of processing that all gins do, the ownership structure of a cotton gin should have no bearing on whether gins are included under any section of this rule. Cotton gins do not convert any raw agricultural commodity into a processed food and do not perform any activity that would not fit within either the harvesting activity classification or the holding activity classification in the regulation. Cotton gins simply separate the seed cotton (a perishable raw agricultural commodity) into three products – seed; fiber; and leaves, sticks and stems. Our industry is asking FDA to modify this rulemaking and issue guidance that clarifies that all cotton gins, regardless of ownership structure or type, are exempt from these requirements. There is no scientific or risk-based rationale for treating certain gins differently solely based on ownership type.

Regarding the problematic Waters of the U.S. (WOTUS) regulation issued by the previous Administration, we are encouraged that the current Administration is acting to rescind the WOTUS rule. While the rescission of the rule has not yet been published in the Federal Register, we are hopeful that it will be soon and look forward to working with the Environmental Protection Agency (EPA) and the Army Corp of Engineers on a common-sense, agriculture-friendly replacement that includes input from key stakeholders, including those in the agriculture and regulated community.

The Endangered Species Act (ESA) is another area of over-regulation that affects farming. The EPA has worked for multiple years with the Fish and Wildlife Service (FWS) in an attempt to meet the legal ESA obligations of both EPA and FWS. However, the required consultation process is not working and continues to serve as a platform for legal action by activist groups. An approach has been developed to help streamline the consultation process, but it has not been fully implemented, so the current process continues to delay pesticide registrations and provide for continual legal action against federal agencies.

Pesticide registrations and re-registrations, even without ESA concerns, are becoming more problematic. The process is controlled by the Federal Insecticide, Fungicide and Rodenticide Act (FIFRA) but in recent years, litigation has been reshaping the process to provide less emphasis on FIFRA. In addition, EPA has come to rely on models that don’t reflect real-world data and instead rely on theoretical modeling data, even when real world data is available. The agency has ignored the benefits of products to concentrate only on risks; relied on biased studies to show risks to pollinators; and developed new risk exposure models that assume exposure is absolute.

Congress can take action, working with the current Administration, to fix this broken ESA consultation process and create a path that allows for a timely, science-based, and comprehensive review of the risks and benefits of crop protection products.

Federal Check-off Programs

The U.S. cotton industry, like many other commodities, has a national commodity research and promotion program (check-off program) to allow the industry's stakeholders to combine resources for the benefit of the industry. The Cotton Research and Promotion Act of 1966 was the first legislation of its kind. It enabled producers of upland cotton and importers of cotton textile products, after passing a referendum, to unite to begin addressing competing fibers and re-establishing markets for cotton. Today, every bale of upland cotton produced and the cotton content of imported cotton products is assessed and those dollars fund a very successful research and promotion program. A recent third-party economic assessment of this program indicated returns to producers and the government of over $7.00 for every one dollar contributed over the life of the program. The return on investment is even higher for importers.

The Cotton Board's members are appointed by the Secretary of Agriculture to administer and oversee the operation of the program on behalf of all stakeholders. The program itself has significant built-in safeguards to protect this investment. In addition, USDA oversees almost every aspect of the program's operation. These are carefully managed, productive programs that generate positive return for U.S. cotton producers and importers of cotton products at no cost to taxpayers. These types of check-off programs should continue and should not be hamstrung by unnecessary legislative or regulatory provisions that do not contribute meaningfully to transparency but would weaken their effectiveness.

Conclusion

In closing, for the past three years, U.S. cotton producers have struggled with low cotton prices, high production costs and the resulting financial hardships. While cotton futures market prices initially increased for a brief period earlier this year relative to year-ago levels, prices have now retreated to the mid to upper-60 cent range, meaning many cotton producers continue to face economic and credit availability challenges. Therefore, it is imperative that the next farm bill bring cotton back into the Title I commodity policy so that cotton can access the same full complement of risk management tools as other crops.

The NCC looks forward to working with the Committee and all commodity and farm organizations to develop and pass a new farm bill that effectively addresses the needs of all commodities and all producers in all regions of the country.

Thank you for this opportunity, and I would be pleased to respond to any questions.