Cotton Industry Briefing Paper

US Farm Bill, Trade Distortions and Cotton Markets

Purpose:

The purpose of this paper is to outline the Australian cotton industry's concerns and position on the new US Farm Bill, (Bill) currently being negotiated by the House of Representatives (House) and Senate and the potential ramifications for Australia, as an efficient producer and exporter of raw cotton.

This paper will be used by an Australian government and industry delegation that will visit Washington in early December to lobby against the Bill. The delegation will be led by the Minister for Agriculture, Fisheries and Forestry, The Honourable Warren Truss.

Background:

The current Farm Bill introduced in 1996 is due to expire in September 2002. Due to the current domestic political situation in the USA, the timetable for the scheduled introduction of the new Bill has been brought forward. It is possible the new Bill may be rushed through the legislative processes prior to Christmas, but more likely, in early January when Congress resumes after the Christmas recess.

To date the House has drafted a ten-year Bill costed at US$174 billion and on 15 November, the Senate Agriculture Committee agreed a US$88 billion five-year draft Bill that will now go to Senate for voting during week commencing 1 December 2001

Subject to the Senate vote, the Bill will move to a joint House/Senate conference where it will be negotiated.

Latest advice suggests that the Bill 'could be introduced as early as Tuesday, yet issues facing the Senate, namely a stalled economic stimulus package desired by President Bush, make any farm bill timetable unsubstantiated. Jay Carson, Tom Daschle's (Senate Majority Leader) press secretary, stated, "it's our hope we can introduce it this week… and we would hope that debate would begin shortly after it is introduced."

'It is also unclear how soon the Senate may vote on the final version of a Bill, particularly because several senators displeased with the legislation will try to amend it before a full Senate vote. Carson said Daschle would keep the Senate in session as long as necessary to finish work on pending legislation. But sources indicated the Senate probably would adjourn for the holidays December 15. A spokesman for the agriculture committee, said both Daschle and Senator Tom Harkin, and the agriculture committee chairman, would like the senate to approve a farm bill by then.[1]'.

'The reality is the House and Senate bills are a ways apart and even though it is difficult to predict the outcome, what we know for certain is that the implications for

[1] Niedens, Lyle. Kansas City, November 27.

the Australian cotton industry will be detrimental unless the industry takes a proactive stance to confront this piece of legislation.'

While Australian Embassy officials have worked tirelessly to voice Australia's concern with the Bill, it is judged critical that the Australian cotton industry explain how continued US production subsidies have a detrimental impact by artificially separating US growers from the dynamics of the world market place. Most recently this has led to increased production and contributed significantly to driving price downwards.

The US Farm Bill

Below is a comparison of the existing Farm Bill, and that passed by the House of Representatives and the Senate Agriculture Committee.

Existing Law	House Farm Bill HR 2646 (10 year Bill)	Senate Committee Farm Bill (5 year Bill)
COMMODITY TITLE		
Counter-Cyclical Support Payments		
The 1996 Farm Bill provides counter cyclical income support through marketing loan gains and LDP's. The only direct counter cyclical payments come through LDP's. Congress has also provided support in recent years through a series of ad hoc disaster assistance payments. Prior to the current law, the 1995 Farm Bill included the following target prices:	Direct counter-cyclical payments on a commodity-by-commodity basis would be provided. Counter-cyclical payments would be made to producers if prices for a commodity fell below a certain level. Payments would be calculated as follows: (Target Price) - (Fixed Payment) - (Higher of: Marketing loan rate or National twelve-month season average price received by producers). Payments would be made on 85% of a producer's base.	Payment rate for each crop would equal: (Income Protection Price) - (Higher of 5-month avg. price or loan rate) Producers would receive counter-cyclical payments equal to: (base acres)X(program yield)X(payment rate) Payments would be made on 100% of a producer's base.
Target Price Upland Cotton: **$0.729**	**Target Price**: Upland Cotton: **$0.736**	**Income Protection Price:** Upland cotton **$0.68**

Nonrecourse Loans		
Loan Rates		
Loan rates are set, generally, at not less than 85% of the 5-year Olympic average price for the commodity and not more than the applicable loan rate cap.	Formulas are maintined.	Formulas are eliminated, and firm loan rates are set.
2001 Marketing Loan Rates Upland Cotton: **$0.5192** *set by formula taking into account the feed value relative to corn	**Proposed marketing loan rate caps:** Upland Cotton: **$0.5192**	**Proposed marketing loan rates:** Upland Cotton: **$0.55**
Decoupled Fixed Payments		
The 1996 Farm Bill provided transition payments for eligible commodities through production flexibility contracts. Payments are based on contract acreage and past production and are "decoupled" from current production. Oilseeds were not eligible for these payments. The 1996 Farm Bill set up a payment rate schedule that was scheduled to decrease payments each year from 1996 through 2002. Payments are made on 85% of crop base and payment yields have been frozen since 1985.	Continuation of transition payments equal to the amount provided in 2002. Payments would continue to be made on 85% of base. The 2002 scheduled payment levels are: Upland Cotton: **$0.0667**	Payments would be made on 100% of base. Direct Payment Rates are reduced over the 5-year life of the bill as follows: 2002/03 2004/05 2006 Upland Cotton: **$0.13 $0.065 $0.0325**
Payment Base		
The 1996 Farm Bill established "Contract Acreage" as a base for payments. The contract acreage was equal to the crop acreage bases that would have	Producers would be able to update base acres if so desired. Under the proposal, payment base may be calculated using:	Base would be determined using one of two options: • 1998-2001 avg. planted acres and prevented planted

been in effect for each producer in 1996 under the previous law. That base was generally the average acres planted and considered planted to each crop for the preceding 5 crop years (1991-1995). For cotton, the basis was the average of the previous 3 crop years (1993-1995).	• •current AMTA acres or • •avg. acres planted to an AMTA contract crop and/or oilseed for 1998-2001 Payment base for decoupled and counter-cyclical payments are 85% of base	acres or • Current AMTA acres plus 5-year soybean planting Producers choosing to retain current base acres would also retain current program yields. Producers electing to update bases would also be able to update program yields to the greater of: • 1998-2001 avg. yield per harvested acre excluding any year the crop was not planted and, at the producer's option, one additional year, or • the farm program payment yield in effect for the 2002 crop year
Planting Flexibility		
Any commodity can be grown on acreage except, in most cases, fruits and vegetables	Flexibility provisions would be maintained	Flexibility provisions would be maintained
Payment Limits		
Payment limitations are set at $40,000/year in AMTA payments and $75,000/year in marketing loan gains and LDP payments in the current Farm Bill. The payment limit for marketing loan gains and LDP's was raised to $150,000 for the 1999 crop year by the 200 Ag Appropriations bill and again for the 2000 crop year by the 2001 Ag Appropriations bill.	Payment limitations are increased to $50,000 for fixed payments, $150,000 for marketing loan gains and LDP payments, and $75,000 for counter-cyclical payments	The payment limitation for combined direct and counter-cyclical payments is $100,000. For marketing loan gains and LDP payments, it is $150,000 with separate limitations for contract commodities; wool and mohair; honey; and peanuts.

An analysis of the draft Bills shows they have little to recommend them from our Australia's perspective.

Preliminary indications are that both the House and Senate Bills are within spending authority established by the FY '02 Budget Resolution. However, some will argue that the FY '02 Budget Resolution was approved under economic circumstances that have changed appreciably, along with national priorities since 11 September 2001, and therefore Farm Bill spending should be scaled back from the levels authorised in these bills.

Australian Cotton Industry Stance:

Whilst the outlook does not look promising for a reduction in government supported production subsidies to US farmers, we must voice our concerns to the US government and others who will listen about the impact caused to other cotton producing and exporting countries.

The Australian cotton industry stance in reference to the Bill is undeniably for it to not be passed in its present form. The Bill is unreasonable; the US is artificially distorting the world market prices for cotton; the US government should be substantially reducing its support programs, rather than enhancing them.

It is not difficult to see that the problem underlying the Australian cotton industry is a world oversupply of cotton coinciding with declining consumer demand. In more normal circumstances if there is an oversupply of a commodity, farmers will tend to reduce their next seasons plantings reducing the overall supply. Market forces then take over and demand naturally increases. However, with the existence of the current Farm Bill, American producers have no reason to reduce their plantings. While market prices are driven lower for US producers, the US government is paying an additional 25c/lb to compensate. US farmers are now receiving up to 50 per cent of their income in subsidies.

In Australia, our growers produce for the international market and respond to market signals. When supply exceeds demand, Australian cotton growers, decrease their plantings in order to minimise their losses. This year's plantings have decreased from approximately 500,000 hectares in 2000/2001 to approximately 420,000 hectares this season.

If the US were to remove both current trade barriers on textile and clothing imports and current subsidies to its producers, the Centre for International Economics estimates that prices for Australian raw cotton exports would increase by around 7 per cent. The impact on Australian cotton production would show a increase by nearly 7 per cent and the aggregate income of Australian cotton producers would rise by around 19 per cent, equivalent to about A$42 000 for each cotton grower [2].

[2] Centre for International Economics, Trade Distortions and Cotton Markets, Page 39, April 2001

A perception exists in the US that Australian cotton growers receive a subsidy in the form of the relative values between the US$ and A$. What is overlooked is the fact that international markets determine the relative strength (or weakness) of the Australian dollar.

What is further overlooked is the fact that most of our industry's major input costs are paid in for US dollars. For example, gene technology, farm machinery, ginning machinery, chemicals and fertiliser. It can also be argued that the cost of money is imported in US dollars.

What should the Australian cotton industry do?

- Lobby for production subsidies to be no greater than in the current Farm Bill.
- Recommend that the US government provide direct income support to their farmers instead of production enhancing subsidies.
- Make US cotton growers aware of the negative impact of their farm support programs have on other cotton producing countries like Australia.
- Seek through the new WTO trade round, the removal of any type of market distortion:
  - Domestic market subsidies that artificially increase cotton production.
  - Export subsidies that distort international trade in cotton.
  - Tariff and non-tariff barriers that artificially restrict entry to markets.

How can the Australian cotton industry achieve these desired outcomes?

- Through the establishment of the ACIC Trade Committee to develop and sign-off on cotton industry positions in relation to trade issues.
- Continue working with Federal government departments (DFAT and AFFA) and NFF in lobbying US and other governments.
- Ensure senior cotton industry representation accompanies Minister Truss's delegation to Washington.
- Ensure the ICAC Private Sector Advisory Panel continues to focus on trade distorting issues and argue for the reduction and eventual removal of subsidies.
- Highlight the outcome of the recently completed WTO Doha meeting in which US Government committed to a reduction in agricultural production and trade distorting subsidies. We need to remind all in the US that a new US Farm Bill will fly in the face of the Doha commitment.
- Target key US media to fuel a US taxpayer protest in regards to how much money goes into supporting already large and profitable US farm enterprises and US trade houses.
- Build further on the recommendations made in the CRDC publication 'Trade Distortions and Cotton Markets – Implications for Australian Cotton Producers.'
- Seek to identify and build alliances with groups who are against agricultural subsidies in the USA.
- Work with the Cairns Group of countries to continue to pursue reform as part of the new WTO round of negotiations.

- Publicise our industry's position against the use of production and export subsidies in Australia to build industry support.

Cotton Australia
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