

Global Welfare Implications of U.S. Cotton Subsidies

American-Greek-Romanian Initiatives to Enhance
Understanding of Multicultural Market
Opportunities, Trade, and Development

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Introduction

- 1) Description of the 10 Major US Cotton Subsidies.
- 2) Welfare Implications of US Cotton Subsidies for the US Economy.
- 3) International Markets for US Cotton Exports.
- 4) Welfare Implications of US Cotton Subsidies for Foreign Countries.

List of U.S. Cotton Subsidies

- 1) Production Flexibility Contracts (PFCs)
- 2) Counter-Cyclical Payments (CCPs)
- 3) Marketing Assistance Loans
- 4) Step 2 Marketing Payments
- 5) Market Loss Assistance (Ad hoc)
- 6) Water Subsidies (California and Arizona)
- 7) Export Credit Guarantees
- 8) Crop Insurance Payments
- 9) Cottonseed Payments
- 10) Tax breaks for extraterritorial export income

(1) Production Flexibility Contracts (PFCs)

- Production Flexibility Contracts are checks that the government gives to cotton producers simply because they own land that historically was used to plant cotton.
- Owners of land that traditionally grew cotton receive this subsidy on 85% of expected cotton production as if the farmer actually decided to grow cotton on the land.
- The landowner, however, does not have to grow anything on the land to receive this subsidy.
- Therefore, this subsidy is totally decoupled from prices and does not affect production (since farmers can do what they want with the land).
- The direct payment rate is \$147/tonne, which translates into \$1.34 billion per year (2002-2004).
- This is considered a Green Box policy under the WTO because it is not tied to prices of a specific crop.

(2) Counter-Cyclical Payments (CCPs)

- The government provides a target price for US cotton producers equal to \$1,596/tonne.
- However, they must subtract the direct payment rate of \$147/tonne from that price, essentially guaranteeing them a price floor of \$1,449/tonne.
- They receive the difference between \$1,449 and the market price on 85% of their expected production, as long as the market price is above the loan rate (currently \$1,146/tonne).
- If the market price is below \$1,146/tonne then producers receive the maximum CCP payment (\$303/tonne) AND the LDP kicks in as well.
- Producers received an average of \$691 million per year in CCP payments (based on 2002-2004).
- This is considered a Blue Box policy under the WTO because it is tied to prices, but acreage is limited to 85% of the possible area.

(3) Marketing Assistance Loans

- A farmer can receive a Marketing Assistance Loan from the government in one of 4 ways:
 - 1) Loan Deficiency Payments (LDPs) – a direct payment instead of a loan, which can be taken during the crop year.
 - 2) Marketing Loan Gains (MLGs) – repaying a loan at the Average World Price (AWP) when it is lower than the loan rate.
 - 3) Commodity Certificates – purchased at the posted county price to repay the loan, with similar results to MLGs but without payment limits.
 - 4) Forfeiting the Collateral (commodity) and keeping the principal (cash) from the loan.
- If the market price exceeds the loan rate when the loan is repaid, the producer repays the principal plus interest.
- If the market price is lower than the loan rate, producers either repay the loan at the lower price or take the LDP.
- Each of the four loan rate methods described above are based on a Loan Rate of (Upland = \$1,146/tonne and ELS = \$1,787).

(3) Marketing Assistance Loans

- The average yearly benefits that cotton farmers received under the various types of Marketing Assistance Loans (1995-2004) are:
 - 1) Loan Deficiency Payments = \$199 million
 - 2) Marketing Loan Gains = \$34 million
 - 3) Commodity Certificates = \$392 million
- Marketing Assistance Loans are considered an Amber box policy, but the WTO recently ruled in favor of Brazil on this issue.
- The WTO decision with respect to Brazil could push marketing loans into the Red Box category.

(4) Step 2 Marketing Payments

- The so-called “Step 2” program provides for Marketing Certificates or cash payments to domestic users and exporters of upland cotton under certain conditions which are:
 - 1) When the U.S. price of cotton exceeds the A Index (Northern European Price) by \$27.55/tonne for 4 consecutive weeks; and
 - 2) The adjusted world price (AWP) does not exceed 134% of the US loan rate.
- The Step 2 payment rate was supposed to be the difference between the US price and the A Index, minus \$27.55/tonne. However, they decided not to subtract the \$27.55 under the 2002 Farm Bill.
- The US government paid an average of \$288 million annually to US mills and US export companies under Step 2 (2002-2004).
- This subsidy essentially behaves as an import subsidy because it allows US mills to import cotton at the world price when the domestic price is higher than the AWP.
- The WTO ruled that this subsidy is prohibited and the US removed it completely on August 1, 2006.

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(5) Market Loss Assistance

- Ad hoc emergency and supplementary assistance provided to producers for compensating potential losses should commodity prices fall under a certain level.
- Used mostly in cases of natural disasters when the President declares a state a federal disaster area.
- Cotton producers received an average of \$258 million per year under this program from 1995-2001.
- However, this subsidy was removed under the 2002 Farm Bill and is not included in the summary slide at the end of this section.

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(6) Water Subsidies (cotton only)

- Production of Extra Long Staple Cotton in California and Arizona represent only 13.7% of US cotton production.
- The average water subsidy received by these states was estimated as \$80.58/tonne. (Schmitz et al., 2007).
- This equals \$198 million per year based on 1999-2003 production levels.

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(7) Export Credit Guarantees

- Also referred to as GSM 102, GSM 103, and SCGP.
- Guarantees US exports against the risk of not being paid, in the event that the foreign bank or importer failed to pay.
- The WTO ruled that this subsidy is prohibited and that the U.S. must remove it by July 1, 2006.
- The US has not yet complied.

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(8) Crop Insurance Payments

- Insurance coverage to producers for losses due to natural disasters and market fluctuations.
- The unsubsidized portion of crop insurance is considered a Green Box Policy.
- The subsidized premiums are of concern, but these subsidies are relatively small.

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(9) Cottonseed Payments

- Ad hoc emergency and supplementary assistance provided to first handlers and producers of cottonseed.
- This subsidy is very small, but it does exist.

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(10) Tax breaks for Extraterritorial Export Income

- Upland cotton producers receive income tax breaks for a small portion of cotton sales that are sold as exports.
- This subsidy is very small, but it exists as well.

Major Annual Cotton Subsidies

- Production Flexibility Contracts = \$1.34 billion
- Counter-Cyclical Payments = \$691 million
- Marketing Assistance Loans = \$625 million
- Step 2 Cotton Subsidies = \$288 million*
- Water Subsidies for ELS = \$198 million

- YEARLY TOTAL = \$3.14 billion

*Eliminated August 1, 2006.

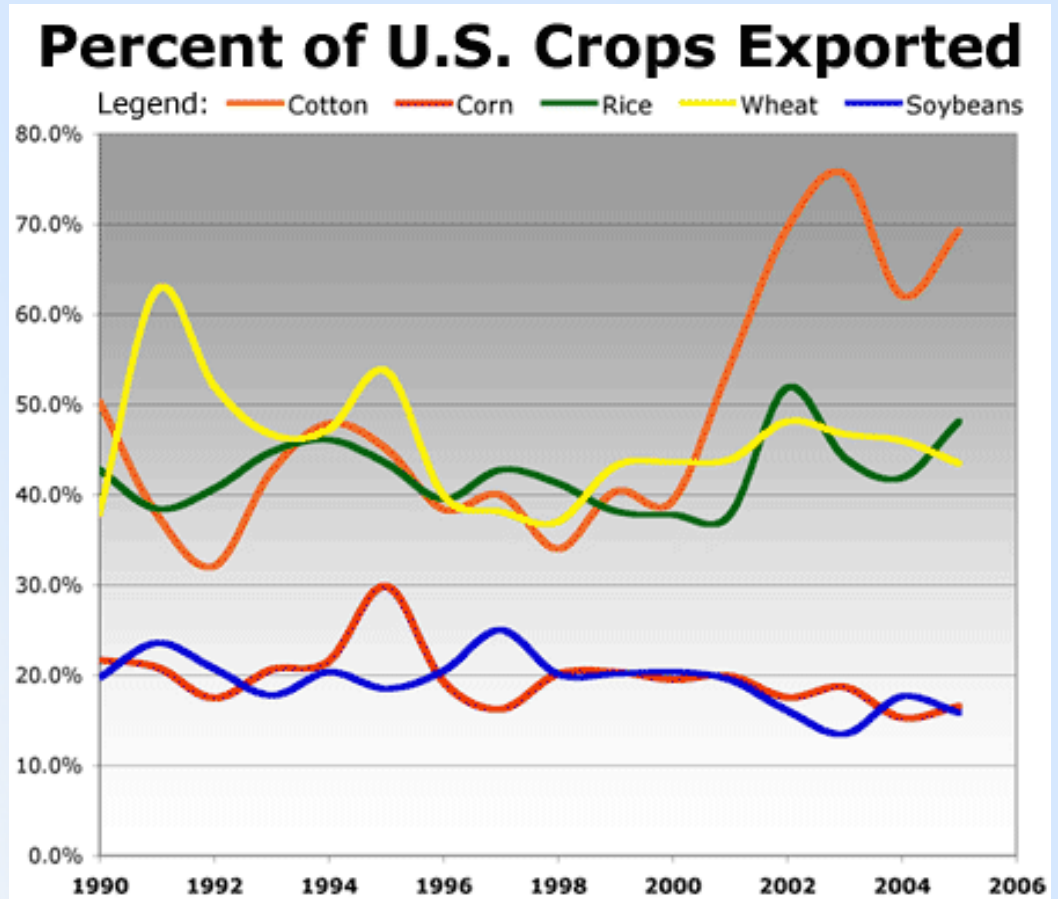
Economic Measures of Welfare

- As US cotton producers receive large subsidies, the method by which these subsidies are transferred from taxpayers to producers causes market inefficiencies.
- These inefficiencies have a significant impact on global cotton markets, because they depress world prices.
- Hence, they are often times referred to as trade distortions.
- These trade distortions result from overproduction caused by:
 - 1) Counter-Cyclical Payments
 - 2) Marketing Loans
 - 3) Step 2 Payments; and
 - 4) Water subsidies (which multiply the magnitude of the effects of the other three subsidies)

Welfare Implications of Removing US Cotton Subsidies on the US Economy

- In a study by Schmitz et al. it was found that if the US eliminated the four subsidies previously mentioned in 2002 (AWP = \$925/tonne):
 - 1) US cotton producers would lose \$1.99 billion.
 - 2) US consumers would lose \$236 million.
 - 3) US taxpayers would gain \$3.37 billion.
 - 4) The US economy would gain \$756 million.
 - 5) Markets would become 33% more economically efficient.
- If these subsidies were eliminated in 2003 (AWP = \$1366):
 - 1) US cotton producers would lose \$830 million.
 - 2) US consumers would lose \$116 million.
 - 3) US taxpayers would gain \$1.77 billion.
 - 4) The US economy would gain \$403 million.
 - 5) Markets would become 47% more economically efficient.

Major US Export Crops





US Cotton Statistics (2002-2004) Million Tonnes

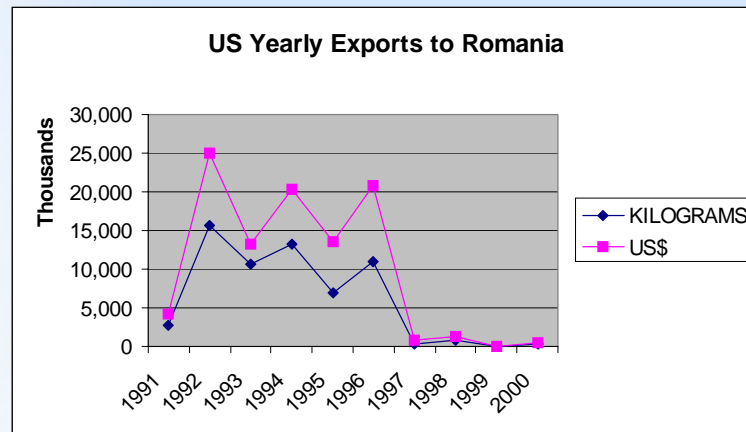
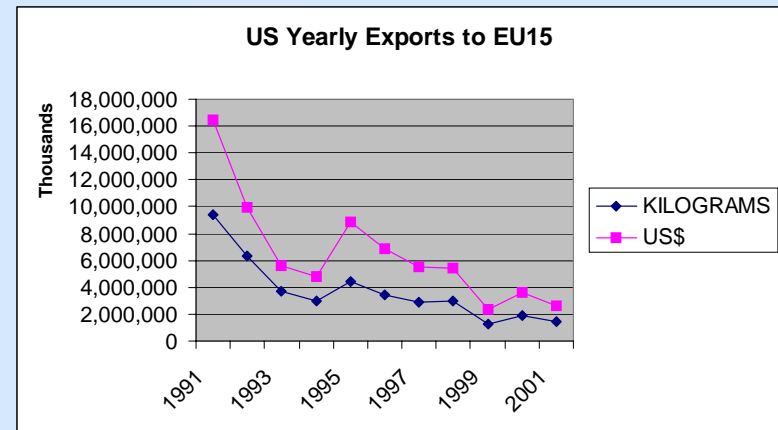
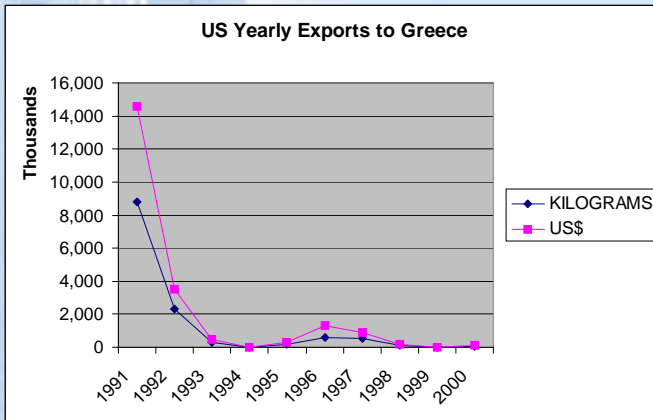
	2002	2003	2004
Production	79.0	83.8	106.8
Consumption	24.7	20.9	40.7
Exports	54.6	63.2	66.1
Imports	---	---	---



Rest of the World Cotton Statistics Million Tonnes (2002-2004)

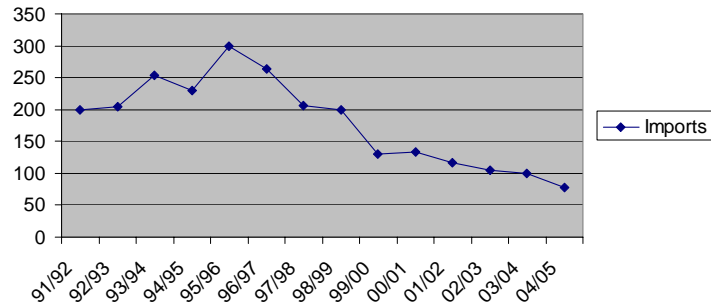
	2002	2003	2004
Production	326	351	410
Consumption	419	422	444
Exports	84.9	88.6	90.4
Imports	178	160	125

US Cotton Exports to Select Countries

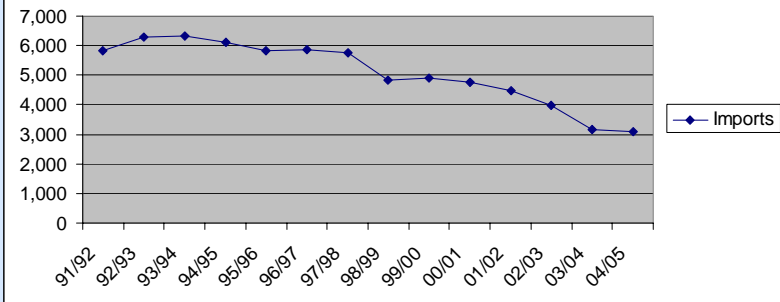


Cotton Imports and Exports by Select Countries

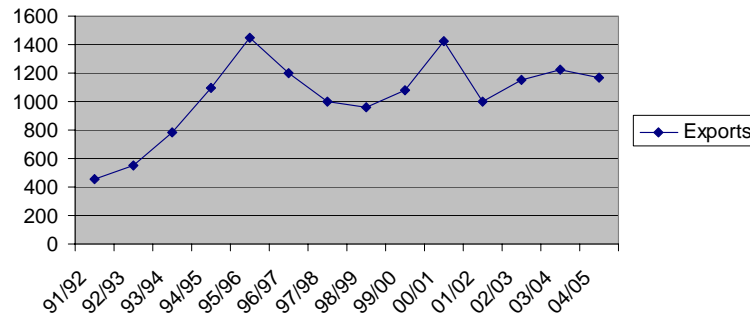
Total Romania Imports from 1991-2005



Total EU Imports from 1991-2005



Total Greece Exports from 1991-2005



Welfare Implications of Removing US Cotton Subsidies on Foreign Countries

- If the four major US cotton subsidies were eliminated in 2002 (AWP = \$925/tonne):
 - 1) The average world price would have increased by 22.8%.
 - 2) Foreign countries would have gained \$482 million.
- If these subsidies were eliminated in 2003 (AWP = \$1366/tonne):
 - 1) The average world price would increase by 8.9%.
 - 2) Foreign countries would have gained \$350 million.