PRODUCTION AND TRADE POLICIES AFFECTING THE COTTON INDUSTRY

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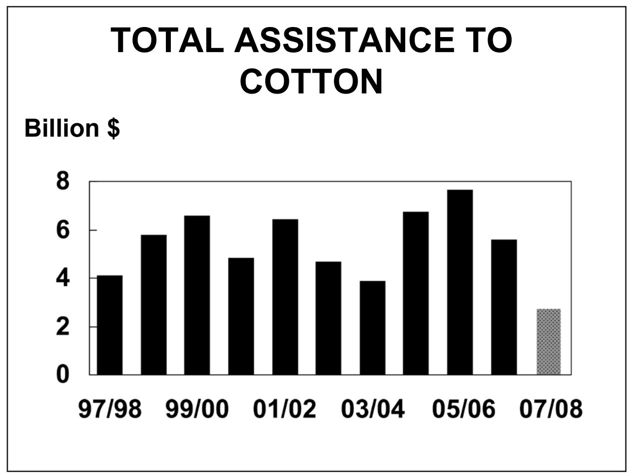
GOVERNMENT SUPPORT TO THE COTTON INDUSTRY

All government subsidies to the cotton industry, including direct support to production, border protection, crop insurance subsidies and export subsidies declined by more than half from $5.6 billion in 2006/07 to an estimated $2.7 billion in 2007/08. This marks the lowest level of government subsidies to the cotton industry since 1997/98, when the Secretariat started reporting on direct government support.

The Cotlook A Index averaged 73 cents per pound during 2007/08, or 14 cents higher than in 2006/07. As a consequence, support provided to the cotton sector declined in some countries.

Direct government subsidies provided by eight countries through production programs fell to $2 billion in 2007/08 from $4.1 billion in 2006/07.

The highest level of direct government assistance since 19997/98 provided to the cotton sector by nine countries through production programs reached $6.2 billion in 2004/05, when the Cotlook A Index averaged 52 cents per pound and a record crop of 26.7 million tons was produced. 14 countries provided $5.8 billion in direct assistance to production in 2001/02, when the Cotlook A Index averaged a three-decade low of 42 cents per pound.



As a result of increased international prices, the estimate of government support to cotton production resulting from border protection policies decreased from $1.5 billion in 2006/07 to $614 million in 2007/08.

The share of world cotton production receiving direct government assistance, including direct subsidies and border protection, increased from an average of 55% estimated between 1997/98 and 2006/07, to an estimated 57% in 2007/08. Since 1997/98, there is clearly a negative correlation between the Cotlook A Index and the amount of world cotton subsidy provided to the industry, as well as the number of subsidizing countries.

The level of direct government assistance provided through export programs decreased from $400 million in 2005/06 to $11 million in 2006/07 and is estimated at $60 million in 2007/08. During the past two seasons, the only export program for cotton has been the U.S. Pima competitiveness program.

USA

The 2002 farm bill was in effect in the USA through 2007/08 and channeled direct support to cotton production through five mechanisms: a direct payment (DP), a counter-cyclical payment (CCP), a loan deficiency payment (LDP), certificate exchange gains and marketing loan gains.

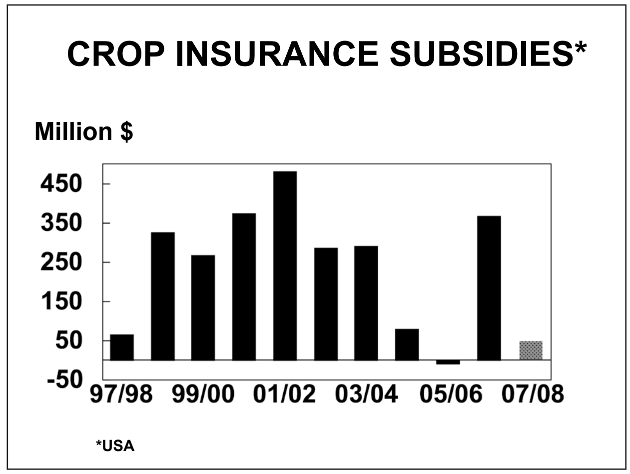
DPs, which are independent of market prices and based on historical planted area and yield, are set at 6.67 cents per pound. The DP increased in 2007/08 to $615 million (+$160 million from 2006/07).

CCPs, which are also based on historical planted area and yield, are paid when the effective price is below the target price. The target price was set at 72.4 cents per pound. The effective price is the DP plus the higher of the national average market price paid to producers or the loan rate. The loan rate was set at 52 cents per pound. The CCP declined in 2007/08 to $416 million (-$865 million).

The LDP is paid when market prices are below the loan rate. The LDP declined to zero in 2007/08 (-$106 million) as market prices stayed above the loan rate.

In addition, producers are able to buy commodity certificates at the rate of the adjusted world price (AWP) and exchange them on the same day for cotton pledged as collateral to the Commodity Credit Corporation (CCC) for a commodity loan. Realized gains from the certificate exchange, called certificate exchange gains, equal the amount by which the loan rate exceeds the AWP. Certificate exchange gains are similar to LDPs. Certificate exchange gains declined to zero in 2007/08 (-$1 billion).

Producers also may receive gains called marketing loan gains if the loan repayment rate is less than the loan principal, also called loan write-offs. Marketing loan gains also fell to zero in 2007/08 (-$7 million).



Another form of government support to cotton production in the USA is provided through subsidized crop insurance to protect producers against losses to crop yields caused by natural disasters. Nearly every cause of decline in crop yields is covered by this multi-peril crop insurance, such as weather, pests, and fire, but not producer negligence. While the insurance is sold to farmers, largely through private insurance providers, the USDA's Risk Management Agency (RMA) pays in excess of 50% of the premiums. Additionally, the RMA pays the private insurance providers about 20% of total premiums toward their administrative and operating costs, plus RMA's own administrative costs, less than 2% of total premiums. On average, more than 90% of planted cotton acreage is enrolled in the program. This form of production support was not included in previous ICAC reports to plenary meetings.

By design, the crop insurance program is supposed to be actuarially sound, meaning that over time total premiums are supposed to cover total indemnities. In practice, however, during the past 10 years, the premiums exceeded indemnities only in 1997, 2004, 2005 and 2007. The net losses (indemnities over premiums) fall upon the government, because it reinsures the privately marketed policies. The net losses are added to the premium subsidies to calculate a total cost of crop insurance to the government.

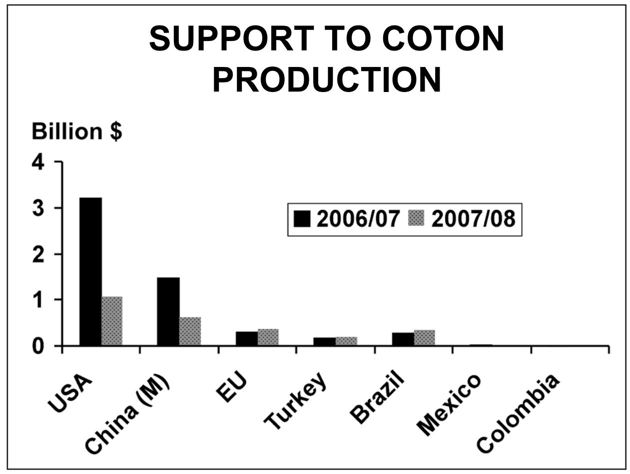
Total premium and indemnity subsidies averaged $234 million per year between 1997 and 2007, with the highest cost of $482 million paid in 2001. The government received $9 million in 2005 when the unsubsidized part of premiums exceeded premium subsidies and indemnities. Total crop subsidies fluctuated from 0.5 cent per pound of total production to 5 cents per pound during the past 10 years. In 2007/08 total crop insurance subsidies are estimated at $43 million, or 0.5 cents per pound of total production.

Total direct U.S. support to cotton production declined from $3.2 billion in 2006/07 to $1.1 billion in 2007/08. During the past 10 years the highest U.S. direct support to cotton production of $4 billion was provided in 2004/05, an equivalent of 35 cents per pound. Average direct assistance to production declined to 31 cents per pound in 2006/07 and to 12 cents per pound in 2007/08.

European Union

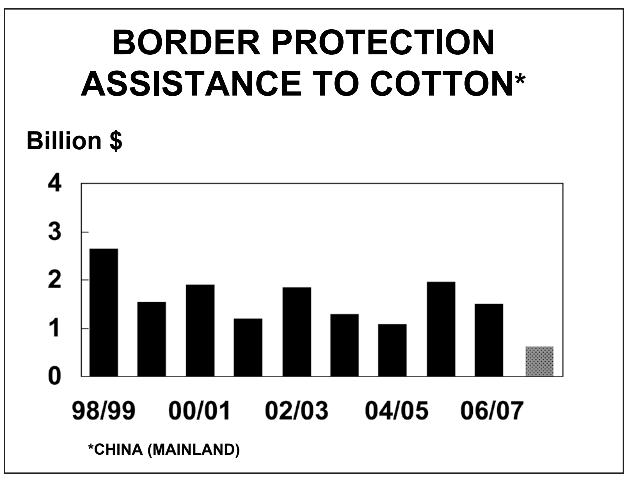
Until 2005/06, payments under the EU Common Agricultural Policy (CAP) were based on estimated seed cotton production for a maximum of 782,000 tons in Greece and 249,000 tons in Spain. Payments had a combined CAP floor payment of €770 million.

Changes in EU CAP policies were made effective January 1, 2006 applicable to the 2006/07 and 2007/08 crop years. Under this new program, EU cotton producers receive 65% of EU support as a single decoupled payment (income aid) and the remaining 35% as an area payment (coupled or production aid). The total budget allocated for these payments is around €770 million, the same as under the previous regime. The 35% coupled payment is given for a maximum area of 370,000 hectares in Greece and 70,000 hectares in Spain and is proportionately reduced if claims exceed the maximum area allocated to each country. To receive coupled area payments, producers must plant cotton and grow the crop until the stage of boll opening in normal agricultural conditions, but they are not forced to harvest the cotton. The amount of coupled support that resulted in actual cotton production in 2007/08 is estimated at $358 million (+$39 million from 2006/07) and most of the increase was caused by the depreciation of the U.S. dollar. The amount of direct subsidy per pound of cotton in 2007/08 increased from 33 to 42 U.S. cents per pound for Greek cotton and from 85 to 103 U.S. cents per pound for Spanish cotton. The higher direct subsidy per pound of cotton in Spain is due to significantly lower-than-average yields.



China (Mainland)

As a result of increased international prices, the estimate of government support to cotton production resulting from border protection policies decreased from $1.5 billion in 2006/07 to $614 million in 2007/08. Policies enacted in 1999 introduced market forces to the cotton sector in China (Mainland). However, as a result of import quotas, domestic cotton prices in China (Mainland) were above international prices in recent seasons. The Secretariat uses the difference between domestic and imported cotton prices as an estimate of the support to Chinese domestic cotton prices that results from border protection.



The price differential between the CC index (an index of mill-delivered cotton in China) and the FC Index L (an index of imported cotton arriving in Chinese main ports), adjusted to include value added tax, port charges and transportation to mills, decreased from 9 U.S. cents per pound in 2006/07 to 3 U.S. cents in 2007/08.

In addition, 500 million Yuan, an equivalent of about $70 million was paid by the central government of China (Mainland) in 2007/08 to growers as a subsidy for using high-quality planting seeds.

Brazil

There are two types of income support programs for producers utilized by the government of Brazil. The first type of program is based on government purchases with guaranteed prices. The second type is oriented at marketing through direct subsidies paid to producers based on guaranteed prices, but without direct acquisition of cotton by the government. The second type of program was implemented in 2006, gained popularity among market participants and continued in 2007 and in 2008. The program actively implemented during 2006/07 and 2007/08 is called the Equalizer Price Paid to the Producer (PEPRO – Prêmio Equalizador Pago ao Produtor). In essence, the premium paid under the program represents the difference between the minimum-guaranteed price and the price the buyer is willing to pay. The minimum-guaranteed price is set at R$ (Brazilian Reais) 44.60 per arroba (15 kg) of lint, or an equivalent of 83 cents per pound at the exchange rate as of June 2008. The PEPRO is used to compensate farmers for the weakening U.S. dollar in relation to the Reais. The actual size of the premium is determined at auctions organized by the government, where a large number of participants in practice bid for the premium. The government's view is that a very competitive auction tends to lead to a lower level of subsidies paid to producers. A total of R$209 million, or US $95 million, was paid to producers under the program during 2005/06, or the equivalent of 4 U.S. cents per pound. In 2006/07, the payments under the program reached R$587 million, or $290 million, the equivalent of 9 U.S. cents per pound. PEPRO auctions held in May-June 2008 resulted in total subsidies paid in 2007/08 amounting to R$549 million, or an equivalent of $337 million.

Other Countries

In Turkey, a higher premium for lint coming from certified seeds resulted in estimated total government payments of $185 million in 2007/08 compared with $196 million paid in 2006/07.

In Mexico, a support price mechanism with a target price of 64 U.S. cents per pound resulted in payments of $38 million in 2006/07, but declined to an estimated $8 million in 2007/08, as a result of higher market prices.

In Colombia, direct government payments to producers in 2007/08 are estimated at $10 million, averaging 10 cents per pound, half of what was paid in 2006/07.

The government of India announced an intention to write off debts in the amount of Rupees 720 billion, or U.S. $18 billion owed by farmers to banks and cooperative banks. The loans will be waived as of end-March 2008 fully for farmers who have less than 2 acres. Farmers who have more than 2 acres will be offered 25% subsidy to settle their debts. Most cotton farmers in India cultivate between 3 and 20 acres so the number of cotton farmers who could receive complete waiver is expected to be negligible. The Indian Cotton Association is trying to assess benefits to cotton farmers from this program through sample surveys.

Level of Direct Assistance Provided by Governments to the Cotton Sector Through Production Programs *

Country	2006/07			2007/08		
	Production	Average Assistance per Pound Produced	Assistance to Production	Production	Average Assistance per Pound Produced	Assistance to Production
	1,000 tons	US cents	US$ Millions	1,000 tons	US cents	US$ Millions
USA	4,700	31	3,221	4,182	12	1,078
Greece	320	33	234	285	42	265
Turkey	750	12	196	675	12	185
Brazil	1,524	9	290	1,603	10	337
Spain	45	85	85	41	103	93
Mexico	142	12	38	137	3	8
Colombia	43	21	20	38	12	10
China (Mainland)	7975	0	0	8078	0.4	70
All Countries	15,499	11	4,083	15,039	5	2,047

* Income and price support programs only. Credit and other assistance not included.

Level of Assistance Provided by Governments to the Cotton Sector Through Border Protection

Country	2006/07			2007/08		
	Production	Average Assistance per Pound Produced	Assistance	Production	Average Assistance per Pound Produced	Assistance
	1,000 tons	US cents	US$ Millions	1,000 tons	US cents	US$ Millions
China (Mainland)	7,975	9	1,499	8,078	3	614

Level of Direct Assistance Provided by Governments to the Cotton Sector Through Export Programs

Country	2006/07			2007/08		
	Exports	Average Assistance per Pound Exported	Assistance to Exports	Exports	Average Assistance per Pound Exported	Assistance to Exports
	1,000 tons	US cents	US$ Millions	1,000 tons	US cents	US$ Millions
USA	2,833	0	11	2,973	1	60
Upland cotton	2,686	0		2,791	0	0
Pima	146	3	11	181	15	60
Total	2,833	0	11	2,973	1	60

Level of Assistance Provided by USA to the Cotton Sector Through Crop Insurance Programs

	Production	Average Assistance per Pound Produced	Crop Insurance Assistance
	1,000 tons	US cents	US$ Millions
1997/98	4,092	0.7	67
1998/99	3,030	4.9	326
1999/00	3,694	3.3	267
2000/01	3,742	4.5	374
2001/02	4,420	4.9	482
2002/03	3,747	3.5	287
2003/04	3,975	3.3	290
2004/05	5,062	0.7	81
2005/06	5,201	-0.1	-9
2006/07	4,700	3.5	367
2007/08	4,182	0.5	47

Total Level of Assistance Provided by Governments to the Cotton Sector Through All Programs *

	Production	Average Assistance per Pound Produced	Assistance to Production
	1,000 tons	US cents	US$ Millions
1997/98	20,180	9	4,108
1998/99	18,810	14	5,772
1999/00	19,188	16	6,588
2000/01	19,529	11	4,833
2001/02	21,672	13	6,446
2002/03	19,579	12	4,669
2003/04	21,110	8	3,892
2004/05	27,011	11	6,737
2005/06	25,525	14	7,673
2006/07	26,636	10	5593
2007/08	26,247	5	2721

* Income and price support programs only. Credit and other assistance not included.