

**REPORT
of the
EXECUTIVE DIRECTOR**

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to the 70th Plenary Meeting of the
**INTERNATIONAL COTTON
ADVISORY COMMITTEE**

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Commodities Without Apology

Mr. Chairman, distinguished delegates, observers and guests, thank you for the opportunity to address this 70th Plenary Meeting of the ICAC since 1939.

Government Involvement Necessary

Since 2008, the cotton market has been whipsawed by declining prices and then record-high prices as well as by extraordinary volatility each season. Long-successful cotton firms have gone bankrupt. Because of disruptions to marketing relationships, producers were unable to sell cotton when prices were falling in 2008 and 2009, and textile mills were unable to buy cotton when prices were rising in 2010 and 2011. Defaults on contracts have increased. Government measures that distort production and trade in cotton and cotton products persist. Yields are no longer rising as fast as a decade ago.

The events of the past three years demonstrate that although the importance of the private sector to regulate, insure, finance and promote cotton production and consumption is recognized by all, the role of governments in commodity industries remains crucial.

For many years, commodities, commodity policies and commodity organizations, have been a bit of an embarrassment to the international community. Commodities were something to “diversify” out of. Commodity “dependence” has been a condition warranting sympathy, and commodity “policy” has been something to avoid since the failure of buffer stock schemes in the 1980s.

However, the events since 2008 with price spikes and troughs and new government interventions in markets, provide clear evidence that the role of governments and the work of International Commodity Bodies (ICBs), including the ICAC, remain central. The ICAC provides transparency and works to standardize quality measures, the ICAC is raising awareness and providing information about responsible production practices, and the ICAC serves as a forum for discussion among governments on matters of international concern, including the proposal to create an international cotton research center. The work of ICBs is fundamental to efforts to raise the incomes of hundreds of millions who earn their livelihoods in commodity value chains, and member governments of the ICAC can talk about commodities and commodity policies without apology.

Transparency

The Cotlook A Index rose to 78 cents per pound in 2009/10 and then exploded to \$1.64 per pound in 2010/11, but daily values of the Index fluctuated between 83 cents per pound and \$2.44 per pound. The factors that underlie both the rise in prices and the volatility in prices, and the implications of the higher prices, carry lessons for the role of governments and the work of International Commodity Bodies.

A lesson from the experiences of 2008/09 when prices fell and volatility was high and 2010/11 when prices rose and volatility was high is that enhanced transparency is necessary to better cotton industry performance. The Secretariat has an excellent tradition dating to the 1950s of collecting and reporting statistics on world cotton supply and use, and the historical database maintained and updated by the ICAC is excellent, providing a sound statistical foundation for analysis and forecast. However, no Secretariat, no matter what resources might be provided, can create accurate data when there are none. Some countries have excellent systems in place for the collection and reporting of timely and accurate data on cotton supply and use and systems to reconcile conflicting estimates. However, many countries have only partial systems reporting on some elements of supply and use without balancing supply and demand and without reconciling differing estimates.

Governments can facilitate better decision making in the cotton value chain by improving efforts to collect and publish timely, relevant, accurate statistics on cotton supply and demand, and particularly data on physical stocks. Universal use of metric measures in reporting cotton supply and use would promote international transparency and market efficiency.

The G20 has acknowledged that market transparency in agriculture must improve and has launched the Agricultural Market Information System (AMIS) to collect global monthly data on food crops. The ICAC is the AMIS for cotton, but the Secretariat relies on countries to provide the basic information that any organization will depend on in compiling world data. The awkwardness toward commodities that has characterized attitudes since the 1970s is manifest in many ways, including a reluctance to invest in commodity information systems. Since commodities have been seen as not important, efforts to gather information about commodities has merited few resources. With the world having learned the importance of agricultural statistics since 2008, it is hoped that governments will increase investments in basic information gathering efforts. The efforts of those governments who participated in the workshop on estimating cotton supply and use in Beijing in June this year, and their endorsement of the foundational importance of accurate statistics to the health of the cotton sector, are much appreciated by the Secretariat.

Government Measures: More than the Three Pillars of the Doha Round

The three pillars of the Doha Round: export subsidies, trade-distorting subsidies and market access, are well known to ICAC Members, and a successful conclusion to the Doha Round resulting in the reduction and eventual elimination of government measures that distort cotton production and trade is desired by all. In addition, the extraordinary price volatility of 2010/11 demonstrates that other forms of government intervention in markets also have unintended negative consequences in the world cotton value chain. The activities of state owned enterprises, limits on exports, and failures to ensure the fulfillment of contracts and the enforcement of valid arbitral awards are also topics of importance to the world cotton industry.

A source of uncertainty, and thus price volatility in the cotton market, is the unpredictable actions of state owned enterprises. The non-transparent workings of some state owned enterprises and uncertainty as to when, or if, cotton will be sold or purchased, is a source of volatility in the world cotton market. The level of stocks held by reserve authorities is often classified as state secrets, and the price thresholds for action by the reserve authorities to buy or sell cotton, and if so in what quantities and qualities and from or to whom, domestic, export or import, are usually unannounced and therefore serve as sources of constant discussion, rumor and speculation by market participants.

Limits on exports in 2010/11 were a significant source of volatility and upward pressure on cotton prices. The WTO, and its predecessor organization, GATT, have worked from the premise that countries wish to export, and thus “discipline” in trade matters has been historically understood to mean restricting the latitude of countries to erect barriers to imports. However, imports are the mirror image of exports, and policies to restrict one are intellectually and practically identical to restrictions on the other. Retroactive disruptions to the fulfillment of contracts exacerbate problems of contract defaults and distort markets by channeling shipments to the advantage of some and the inherent disadvantage of others. Such policies are rarely, if ever, imposed on trade in polyester and other chemical fibers. Many consuming countries are wholly or largely dependent on imports for supplies to their textile sectors. Therefore, limits and distortions to trade in cotton have negative long-term impacts on the cotton value chain worldwide as spinners respond to such disruptions by reducing cotton use in favor of other fibers.

Government policies that are transparent and well publicized facilitate good private sector planning. Markets can adapt to changes in policies, but frequent changes or changes with retroactive application force market adjustments that result in added price volatility.

The world cotton industry is marred by an unusually high level of defaults on contracts for international trade, and the volatility in prices during the last three seasons, particularly the rise and fall in prices during 2010/11, resulted in an even higher incidence of defaults than usual.

The incidence of defaults on contracts in cotton are higher than in the grain and oilseed industries because of the disaggregated nature of the cotton industry in which tens of thousands of ginneries sell to several thousand domestic and international merchants, who then ship to between 3,000 and 5,000 textiles mills worldwide. The cotton industry is not highly concentrated by the standards of other agricultural industries, and the 14 largest cotton merchants, defined as companies handling at least 200,000 tons per year, only

account for a little over one-fourth of world cotton trade¹. Because trade is disaggregated, industry entry and exit is common and many firms are undercapitalized relative to the risk inherent in cotton markets.

An average contract for trade in cotton (the mode) is between 100 and 200 tons, and cotton is often sold several times between origin and destination. With world trade at about 8 million tons, there are between 100,000 and 200,000 separate contracts for trade in cotton executed each year; the volume of contracts in cotton make some defaults inevitable.

In a “normal” year, defaults on contracts for trade in cotton seem to account for about 2% of all contracts written. Most of these defaults are settled amicably by rescheduling shipments, substituting origins or by the payment of claims, and only about one hundred disputes are registered with arbitral bodies each year. However, in years of exceptional volatility, the incentives to default increase. When prices are rising, some producers/ginners will refuse to deliver on contracts signed earlier in the season, and when prices are falling, some textile mills will refuse to open letters of credit on contracts signed at higher prices.

Disputes among parties may have risen to as much as ten percent of all contracts for cotton intended for international trade during 2010/11². The potential for defaults contributed to uncertainty, and thus volatility. The reality of defaults forced textile mills and merchants who thought they had secured adequate supplies to buy additional cotton as prices rose, effectively doubling the realized demand in the market for cotton on which defaults occurred. Since prices peaked in March 2011, there are additional reports of textile mills refusing to take delivery, forcing sellers to seek alternative buyers, and effectively doubling the supply of cotton on which defaults occurred.

Commodities are not an embarrassment, and policies that expand trade in commodities deserve consideration. Governments have a fundamental role in commodity trade by ensuring the rule of law, including contract fulfillment. The New York Convention of 1958 requires signatories to ensure that valid arbitral awards involving international trade are automatically enforceable in their countries. All governments are encouraged to support international trade in cotton and other commodities by ensuring the enforcement of valid arbitral awards, by supporting the work of International Commodity Bodies, by encouraging companies to abide by the rules of industry associations and by demanding adherence to legal norms by companies operating within their borders.

Acknowledging the Many Facets of the ICAC

Expert Panels and Task Forces

The International Committee on World Cotton Research (WCRC) created in 1994, the Private Sector Advisory Panel (PSAP) created in 1999, the Task Force on Commercial Standardization of Instrument Testing of Cotton (CSITC), created in 2003, the Expert Panel on Social, Environmental and Economic Performance of Cotton Production (SEEP) created in 2007, and now the Round Table on Biotechnology in Cotton created this year, extend the work of ICAC beyond the subject matter competence of the Secretariat and enable ICAC to provide concrete and important services to the industry and Member Governments.

The WCRC - 5 will be held in Mumbai, India in November this year. Approximately 800 researchers from around the world will participate in the most visible and most effective forum for the sharing of cotton science in the world. The work of the National Organizing Committee in India to arrange for visas, hotel reservations, the conference facility, trade booths and the social program are much appreciated. The services of members of the International Committee, and the work of the National Organizing Committee of the WCRC-5, headed by Dr. C.D. Mayee, have been vigorous and highly effective, and the WCRC – 5 will surely be a very productive conference.

¹ The Structure of World Cotton Trade, ICAC Secretariat, http://www.icac.org/cotton_info/publications/reviews/articles/erev_january_2009_trade_structure.pdf

² Estimate by the ICAC Secretariat based on conversations with traders, industry publications and judgment; no published sources are available.

The creation of the PSAP has broadened the circle of participation in ICAC meetings, expanded the subject matter expertise available to Member Governments and the cotton industry and helped to ensure that the work of the ICAC is relevant and pragmatic. The PSAP met in Washington, USA in May 2011 and issued a report that included opposition to limits on exports, concerns about BCI, endorsement of efforts toward harmonization of phytosanitary certificates used in cotton trade, and encouragement of efforts to provide factual information about cotton production practices.

The PSAP has been vigorous in defending the concepts of Good Trading Practices and encouraging industry standardization. I wish to thank all members of the PSAP, including Manfred Schiefer and Alois Schönberger, Chair and Vice Chair of the PSAP, respectively. Neal Gillen represents the ICAC Secretariat at the United Nations Commission on International Trade Law (UNCITRAL). All members of the private sector serve at their own time and expense, and their contributions are crucial to the work of the ICAC.

At its founding in 2003, there was much skepticism about the need for a new expert group with an unwieldy name. However, the CSITC has proven itself. CSITC Round Trials are conducted among testing laboratories around the world to ensure standardization of test results, and CSITC is providing concrete support to the cotton industry through improved efficiency in cotton quality evaluation. The CSITC Chair, Andrew Macdonald, Rapporteur, Zbigniew Rostwitalski, and all members of CSITC are to be commended for their work. All countries are urged to ensure that testing centers serving their farmers and textile industries are participating in the Round Trials.

SEEP concentrated last year on approval of a consultant's study on insecticide use in cotton and approval of an interpretive summary of the report. During the current year, SEEP focused on labor issues in cotton production. The work of SEEP is crucial to cotton industry efforts to encourage improvement in production practices, and the work of all members of SEEP, including their officers Allan Williams and Francesca Mancini, is very helpful.

Common Fund for Commodities, the EU and Other Donors

The ICAC serves as the International Commodity Body for Cotton and Cotton Textiles with the Common Fund for Commodities (CFC). Since the Fund became operational in the early 1990s, a total of 22 cotton projects valued at over \$70 million have been supported. The CFC has provided \$5.7 million in loan financing and over \$25 million in grant financing for the projects. Co-financing has accounted for \$16.3 million and counterpart contributions have accounted for over \$20 million in total project costs.

The European Union, under its program for African, Caribbean and Pacific countries (ACP) is providing substantial support for the cotton sector. The EU support is channeled through the CFC to ensure coherence in delivery and efficiency in oversight.

The World Trade Organization (WTO) Director-General's Consultative Framework Mechanism on Cotton records cotton-specific development assistance provided by ICAC members Brazil, France, Germany, and the United States, as well as assistance provided by other countries and several multilateral organizations. The work of the Secretariat of the CFC, under the direction of Managing Director, H.E. Ambassador Ali Mchumo, and the work of the EU, the WTO and all actors seeking to enhance productivity and raise incomes in the cotton sector, are having concrete beneficial impacts on the lives of millions.

International Forum for Cotton Promotion

The International Forum for Cotton Promotion (IFCP) facilitates national efforts to build demand for cotton by providing positive information about cotton to consumers. The IFCP is a private sector organization composed of member associations from around the world. The IFCP serves as a clearinghouse for proven techniques of cotton demand enhancement. Its executive director Jeff Silberman, Chair Zbigniew Roskwitalski, Vice Chair Nayan Mirani, and Acting Treasurer Mark Messura, ably lead the IFCP.

Secretariat

The ICAC Secretariat consists of nine full time and two part time members who together prepare the reports, send publications, compile the data, organize the meetings and take the minutes that comprise the visible output of the ICAC. On a dollar-for-dollar basis, the ICAC Secretariat is at least as productive as any in the world, and it is a pleasure to be working with each of them. The longest-serving member of the Secretariat, our business manager Fred Arriola, will retire at the end of June 2012. Mr. Arriola has worked with the ICAC since 1978, and in over 30 years there has not been a single instance of financial impropriety, inconsistency of accounts or difficulties with audits. I take this opportunity to specifically thank Mr. Arriola for his years of service to the ICAC.

Standing Committee

Patrick Packnett of the United States, Lily Munanka of Tanzania and François Schmidt of Switzerland served as officers of the Standing Committee since the 69th Plenary Meeting last year. The Standing Committee discussed a proposal from the Secretariat to create a Cotton Solutions Center, and a report from the Standing Committee will be discussed during this meeting. James Johnson of the U.S. served as Chair of the Subcommittee on Budget. The work of all members of the Standing Committee in coming to meetings, reviewing budgets, participating in discussions and providing instructions to the Secretariat are important to the efficient functioning of the ICAC. It has been a pleasure to work with Standing Committee members during this past year.

Plenary Meeting Organizing Committee

It has been a great pleasure to work with the Government of Argentina, including provincial officials, to prepare for the 70th Plenary Meeting. Argentina joined ICAC in 1946, and this is the 2nd ICAC Plenary Meeting hosted in Argentina. The creative arrangement for the agenda on Friday visiting cotton producing areas will add substantially to the value of this ICAC meeting.

Switzerland has extended a specific invitation to the Committee to host the plenary meeting in 2012, and the Secretariat will be working to secure invitations for future meetings as quickly as possible.

Conclusion

The last three years have been among the most difficult for cotton and other commodities, but in difficulties there are opportunities. The experiences of the last three years have helped to raise the profiles of commodity industries and, hopefully, to encourage government officials to see commodities as industries of growth and development. Commodity production is no longer a source of embarrassment, and specific policies to provide transparency, strengthen trade, raise yields and ensure efficiency are again topics of discussion at the highest levels of government. The ICAC is well positioned to serve the interests of governments and the private sector in raising awareness of cotton issues, providing information necessary for decision making and fostering cooperation.

I thank member countries for the privilege of serving as executive director, and I look forward to a successful 70th Plenary Meeting.

