



Economic & Policy Situation for U.S. Cotton in 2018/19
National Cotton Council
October 2018

Introduction

U.S. cotton producers, along with the other six segments of the industry, operate in highly integrated and competitive global fiber and textile/apparel markets. Approximately 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.

Acreage and Production

While cotton planted acreage increased to 14.0 million acres in 2018, the abandonment rate is projected to be much higher than in recent years. USDA projected a 25% abandonment rate for the U.S. crop in the October WASDE report due to the severe drought conditions in the Southwest. During the growing season, cotton conditions in the other production regions were generally positive except for pockets of dry conditions in portions of the Southeast and Mid-South. Unfortunately, those conditions took a turn for the worse in the Southeast due to severe weather events. Hurricane Florence has reduced the yield and quality potential of the North Carolina and South Carolina cotton crops. Recent untimely rainfall during the Mid-South harvest will likely lead to yield and/or quality losses. Now, Hurricane Michael has struck the heart of the cotton producing region in the lower Southeast, with extensive damage in southeast Alabama, the Florida Panhandle, and a wide path across Georgia. USDA's first crop condition report following Michael shows 54% of Georgia's cotton acres rated in the Very Poor/Poor category.

Export Markets

For more than a decade, China has been a key market for U.S. cotton fiber exports, and currently ranks as the second largest export destination for U.S. cotton behind Vietnam. In the 2017 marketing year, China purchased approximately 2.6 million bales of U.S. cotton. Of that total, upland cotton accounts for 2.4 million bales with ELS or pima cotton accounting for 210 thousand bales. For ELS cotton, export sales to China represent 33% of total export commitments. For upland cotton, sales to China are 16% of sales to all destinations.

In the absence of retaliatory tariffs, China was expected to purchase approximately 3 million bales of U.S. cotton in the 2018 marketing year. By the end of September, Chinese textile mills accounted for 1.9 million bales of commitments for the 2018 crop. Prior to the current trade tensions, that strong buying pace was expected to continue in view of China's growing demand for cotton, declining stockpiles, and their gap between domestic production and consumption.

According to USDA's weekly export reports, there have been both cancellations and destination changes for sales that were originally made to mills in China. In many cases, the cancelled sales have been shifted out to the 2019 marketing year. Since early June, the combined amount of destination changes and cancellations for the 2018 marketing year is approximately 300,000 bales with Vietnam being a primary destination of the redirected sales. A key question hanging over the market is the ultimate fate of the remaining 1.9 million bales of sales currently on the books to Chinese mills. With the 25% tariff in place, more cancellations and destination changes are expected.

Figure 1 shows the December 2018 cotton futures prices since the beginning of the year along with a timeline of announcements and events surrounding the U.S. – China trade dispute. The application of the 25% tariff continues to impact the U.S. cotton industry and has resulted in lower U.S. prices.

Figure 1: Cotton Prices and China Trade Policy



U.S. cotton is now less competitive relative to growths from countries such as Australia, Brazil and India. In addition, China is the largest producer of polyester fiber, and textile mills can adjust their blends to incorporate more polyester at the expense of cotton. It is expected that as Chinese mills seek to source from other cotton-exporting countries, U.S. cotton will have an opportunity to gain some traction in other markets. However, that shifting of trade comes with additional costs and those sales will likely be secured at lower prices. U.S. cotton producers feel the direct impact in terms of lower prices, but U.S. merchandisers will be hit with increased transportation and storage costs as they seek new markets. In addition, financing costs for export sales to key markets such as Bangladesh and Pakistan can be greater than those for sales to Chinese mills.

Given the importance of the Chinese market to U.S. pima exports, the impact of tariffs on pima prices is expected to be greater than on upland prices. The spillover effects from soybeans into cottonseed and other oilseed markets must also be taken into consideration. Soybean and cottonseed markets are highly correlated and the decline in soybean prices is pressuring cottonseed oil prices lower.

There are also concerns about the longer-term impacts on the trade if the tariffs remain in place. The tariffs could damage U.S. cotton’s reputation as a reliable supplier of cotton, which is a reputation the industry has worked hard over the years to earn.

Market Facilitation Program (MFP)

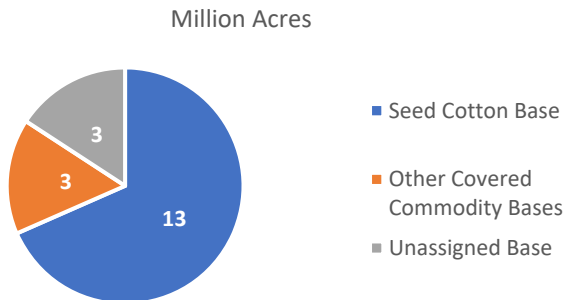
In response to the negative impact of China’s 25% tariff on the U.S. cotton industry, USDA is providing support for the 2018/19 marketing year under the Market Facilitation Program (MFP). The first MFP payment rate for cotton is \$0.06/lb. Cotton producers will receive \$0.06/lb on 50% of their actual production for the 2018/19

marketing year. Based on average U.S. yields, the MFP payment would be approximately \$25 per harvested acre. However, based on the price impacts in cotton fiber and cottonseed, the total support provided under the MFP will fall short of the full market impacts of the tariff.

2018 Seed Cotton Program

USDA is currently implementing the 2018 seed cotton program that was authorized in the Bipartisan Budget Act. To be eligible for participation in either the ARC or PLC program, farms with generic base acres will have options to convert the generic acres to seed cotton base, other covered commodity bases, and unassigned base. Under the 2014 Farm Bill, upland cotton base of approximately 19 million acres was converted to generic base. Based on NCC’s county-level analysis, the 19 million acres of generic base are estimated to be converted to: 13 million acres of seed cotton base (68%); 3 million acres of other covered commodity bases (16%); and the remaining 3 million acres of generic base will become unassigned base with no payment eligibility (Figure 2). The generic base conversion could result in 32% less seed cotton base acres eligible for Title I program payments as compared to the eligible cotton base acres in the 2002 and 2008 Farm Bills.

Figure 2. Estimated 2018 Generic Base Conversion



No other crop has voluntarily taken a reduction in base acres eligible for Title I programs in order to improve the safety net in a way that is budget neutral, resulting in no increase in total commodity specific support. The Seed Cotton program established as part of the Bipartisan Budget Act of 2018 makes seed cotton a covered commodity eligible for the ARC/PLC program effective for the 2018 crop year. The program was established by utilizing existing budget resources already dedicated to cotton and cotton-related programs and was scored as budget neutral according to the Congressional Budget Office (CBO). The Bipartisan Budget Act did not provide “new” money for cotton despite continued assertions to the contrary.

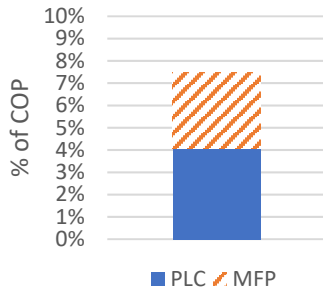
Under the 2018 Seed Cotton program, producers had the opportunity to update their payment yields using 90% of their 2008-2012 average yields, which was the same option for other covered commodity producers in the 2014 Farm Bill, which cotton could not participate since it was not a covered commodity when the 2014 Farm Bill was enacted. Many commodity producers were able to increase their old CCP payment yield to a higher PLC payment yield under this provision. However, this yield update provision is not beneficial for many cotton producers and producers with other crop bases (i.e. wheat, sorghum) in the Southwest region due to severe drought conditions during 2008-2012. Overall, total payment pounds are estimated to be 27% lower than in previous farm bills with the generic base conversion and yield update.

Projected Support for Upland Cotton for the 2018/19 Marketing Year

Currently, USDA projects a marketing year average price of \$0.73 per pound for cotton and \$135 per ton for cottonseed. Based on a weighted average of the two prices, the expected seed cotton price is \$0.3486 per pound, resulting in a PLC payment rate of \$0.0184 per pound. Based on the expected U.S. average seed cotton payment yield, the PLC payment is estimated at \$30 per base acre. When combined with the MFP payment, total support for the 2018/19 crop year is approximately 7% of the total costs of production (COP) (Figure 3).

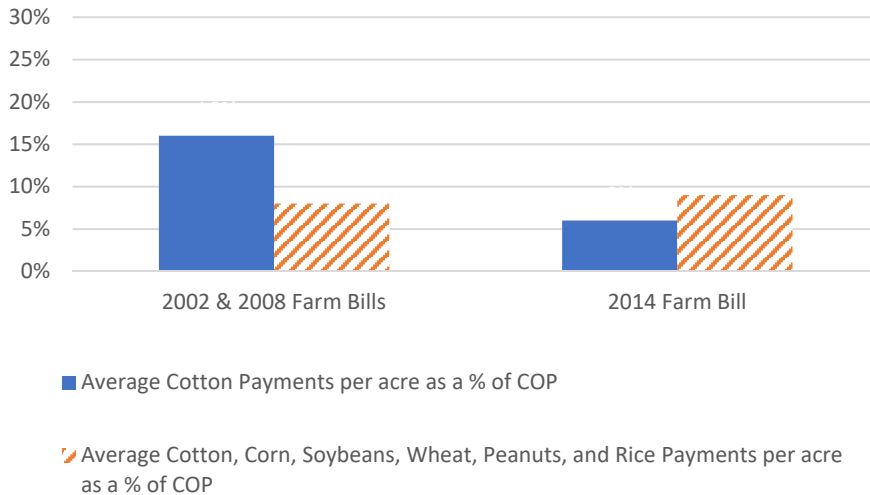
It should be noted that a recent article¹ erroneously attributed support from previous programs to the 2018 crop. Specifically, the Cotton Ginning Cost Share (CGCS) program was only authorized for the 2015 and 2016 crop years. The CGCS program announced by USDA in March 2018² provided a one-time payment for the 2016 crop year.

Figure 3: 2018/19 Projected Upland Cotton PLC³ and MFP⁴ Payments as a % of COP



Overall, average cotton support under the 2014 Farm Bill has fallen short of the support provided in previous farm bills (Figure 4). Under the current farm bill, support to cotton is comparable to the average support provided across the major program crops. It should be further noted that overall support under the current legislation is less than 10% of the costs of production.

Figure 4. Title I Average Commodity Support as a % of COP



¹ Coppess, J., C. Zulauf, G. Schnitkey and N. Paulson. "The Farm Bill Stalemate, Part 1: Commodity Assistance." *farmdoc daily* (8):180, Department of Agricultural and Consumer Economics, University of Illinois at Urbana-Champaign, September 27, 2018.

² USDA FSA Cotton Ginning Cost Share (CGCS) Program: <https://www.fsa.usda.gov/programs-and-services/cgcs/index>.

³ PLC paid on 85% of seed cotton base acres. Projected 2018 PLC payment rates are available at: https://www.fsa.usda.gov/Assets/USDA-FSA-Public/usdfiles/arc-plc/pdf/2018_plc.pdf. Projected ARC seed cotton payments not included since USDA FSA does not publish projected 2018/19 county yields.

⁴ MFP paid on actual 2018 cotton production.