

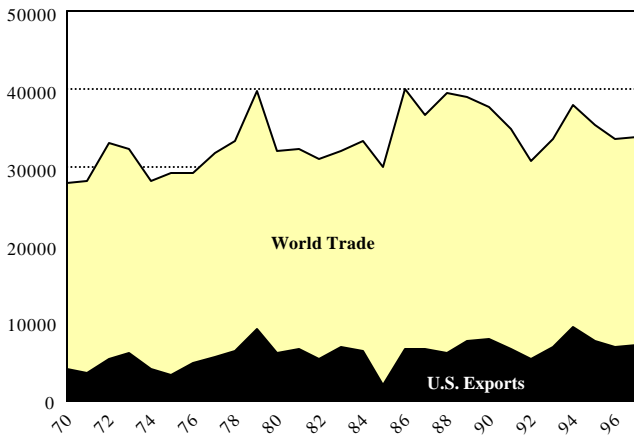
Leaflet 2. Cotton and the World Trade Organization

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Trade Situation and Outlook

Cotton continues to be an important crop for the U.S. and the U.S. continues to maintain an important position in world cotton trade. With approximately 25% of the world market export share, the U.S. is the world's largest exporter of cotton. Market prospects have generally been good, with market share increasing through time. The break-up of the Former Soviet Union in 1992 caused a minor disturbance of world trade as these former Soviet Republics liquidated excess stocks, but that disturbance appears to have dissipated. China, however, remains an

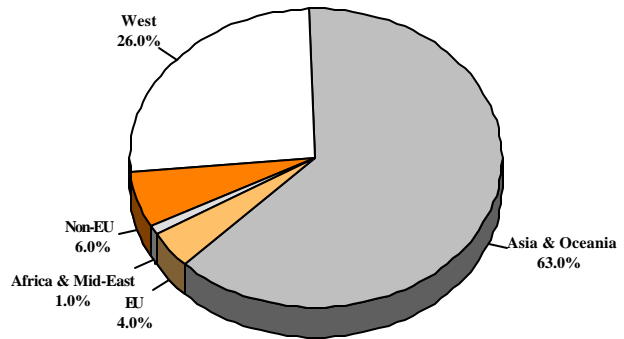
Exports of Cotton ('000 480 lb bales)



enigma. Their policy focus has shifted to food rather than cotton production. Increased polyester capacity has reduced overall cotton demand in China, which will ultimately reduce global demand. This will be a challenge for the U.S. as China has been a major customer for U.S. cotton.

Major Export Customers. The top 11 markets for U.S. cotton in the past three years have been (1) China, (2) Mexico, (3) Japan, (4) South Korea, (5) Indonesia, (6) Other Western

Hemisphere countries as a group, (7) Turkey, (8) Taiwan, (9) Canada, (10) Thailand, and (11) Brazil. Exports are relatively concentrated in the Asian part of the world. As such, exports have



recently suffered as a result of the Asian financial crisis. Western Hemisphere countries have increased consumption of U.S. cotton by about 43 percent since the 1995/96 marketing year with Mexico being the primary source of that growth. The North American Free Trade Agreement (NAFTA) has had a beneficial impact on cotton exports to that region. In contrast, exports of cotton to Canada have remained essentially unchanged since 1995. The surge in textile production in Mexico and U.S. imports of textile from Mexico, accompanied by U.S. direct investment in the textile industry in Mexico, likely account for the differential growth rates in U.S. exports of cotton to Mexico as compared to Canada. China remains the driving force behind market outcomes for U.S. cotton. How global policy may affect exports of U.S. cotton is filtered through how those policies affect China and the rest of Asia.

Major Cotton Trade Issues

Cotton, unlike many other commodities, is not *directly* affected by changes in the WTO, *per se*. The effects on cotton are felt more *indirectly* through the impacts of policy changes on textiles. Several of these factors are discussed below.

Domestic Agricultural Support. Cotton is primarily produced in developing countries. Most of these countries do not “support” cotton production through production subsidies. Rather, many countries tax cotton production, resulting in negative rates of protection. The WTO does not regulate this behavior so that reductions in production subsidies are not particularly germane in cotton. Some countries, however, do provide indirect subsidization through input subsidies. Thus, the continued debate over reductions in domestic agricultural support in the WTO are not likely to have a large direct influence in cotton.

Tariffs. Tariffs are not a major sticking point with cotton. However, some trading blocks do maintain a common external tariff (MERCOSUR’s is 6%), which does limit some exports into these countries. However, for the most part, cotton is relatively “freely” traded in the sense that there are very few tariff barriers placed on exports or imports of cotton. However, some countries have and continue to use such policies as variable export levys, which lower the domestic price of cotton in those countries. Although more indirect, these policies do essentially prohibit importation of cotton by making foreign cotton much more expensive relative to domestic cotton.

Multi-Fiber Arrangement. Likely the most profound impact on world cotton trade will come from the continued phase-out of the Multi-Fiber Arrangement (MFAs), which are bilateral trade agreements between textile exporting/importing countries regulating market access for textile products. The Uruguay Round of the General Agreement on Tariffs and Trade (UR GATT) mandated the phase-out of the MFAs, which essentially gives textile producing countries unfettered access to markets. The likely result of this phase-out will be a shift, at least to some extent, in textile production to lesser-developed countries (LDCs) due to labor cost differentials. This shift in textile production, then, will result in a shift in world cotton trade flows. However, current technological advantages maintained by the U.S. and other developed economies will mean that this shift will not be a complete shift in textile production away from developed economies, but the LDCs will likely increase production in those portions textile production process that are labor-intensive. This has already happened to some extent. The phase-out of the MFAs will likely serve just to accelerate the process.