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The End of an Era: Cotton is no Longer Prominent in the WTO

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EXPERT's Column

Dr. Terry Townsend

The World Trade Organization (WTO) completed its 11th Ministerial Conference (MC11) since its founding 1995 on 13 December 2017 in Buenos Aires, and the closing statements were remarkable for the omission of any reference to cotton. (https://www.wto.org)

MC11 ended with modest progress on reducing fishing subsidies and pledges to avoid imposing customs duties on electronic transmissions for two years. There was no mention of cotton in the closing statements.

Cotton has been called a "litmus test" of the commitment of developed countries to the Development Round, and a "poster" for the Doha Development Agenda (the Doha Round), and in previous WTO ministerial meetings, cotton was a major issue. MC11 marks the end of an era in which cotton and issues related to cotton were central to international trade negotiations. Now, cotton is just one more commodity again.

The Doha Round of multilateral trade negotiations was launched in 2001 with most countries eschewing sectoral specific initiatives, and if you were to have picked a commodity to serve as the poster for development within the Round, it would probably not have been cotton. The gross value of world cotton production is smaller than for other major crops. For example, the gross value of world cotton production in 2001 when the Doha Round was launched was about $30 billion. In contrast, maize was $87 billion, soybeans $49 billion, sugar cane as well as beets were $52 billion, and wheat was $93 billion. (FAO, 2015). Additionally, cotton is primarily a fibre crop, not a food crop, which means it is not usually associated with food security, a traditional focus of government concern.

Nevertheless, cotton rose to prominence in the Doha Round because the President of Burkina Faso attended a WTO meeting in 2003 (it is unusual for a head of state to attend such a meeting) and demanded that cotton be addressed specifically. Speaking on behalf of Benin, Burkina Faso, Chad and Mali, collectively known in the WTO as the C4, the President of Burkina Faso noted that cotton is the only good of any significant value exported by the C4, and he asserted that subsidies in developed countries depressed world prices thus hindering efforts at income generation and economic development in developing countries. He stated simply that the C4 could not support completion of the Round unless the cotton issue was resolved, an ominous threat in an institution that requires unanimity.

The prominence of cotton became official in 2005 at the next WTO meeting in Hong Kong, when member governments agreed to treat cotton "ambitiously, specifically, and expeditiously within the talks on agriculture" in the Doha Development Agenda, the only commodity singled out for specific treatment. From then until this year, at every WTO meeting in which agriculture was discussed, cotton was a prominent part of each conversation.

The 2011 Geneva WTO Ministerial Conference reaffirmed the commitment of members of the WTO to address cotton "ambitiously, expeditiously and specifically", within the agriculture negotiations.

The Bali Ministerial Declaration issued in December 2013, included a specific "Decision" in which Ministers said again that they would address cotton "ambitiously, expeditiously and specifically", within the agriculture negotiations.

At the Tenth WTO Ministerial Conference in Nairobi in December 2015, Ministers again issued a specific "Decision" on cotton, with countries pledging to grant duty-free and quota-free market access for exports by Least Developed Countries (LDCs) of cotton-related products and to eliminate export subsidies on cotton.

But, at the 11th Ministerial Conference just completed, cotton was just one of many issues and special interest concerns competing for the attention of government leaders. There were events and activities related to cotton conducted on the margins of MC11, but these were not central to discussions among ministers.

One cotton-specific achievement announced in Buenos Aires was the launch by the WTO and the International Trade Commission (ITC) of a "cotton portal." The portal is supposed to provide a single online entry point for all the cotton-specific information available in WTO and ITC databases. The Cotton Portal includes information on market access, trade statistics, and country-specific contacts related to cotton market access to make it easier for cotton exporters, importers and investors to contact each other and complete trade deals. As interesting as the launch of the cotton portal is, and not to diminish the work of the ITC, the addition of a new source of data on cotton trade contacts is hardly a major diplomatic achievement. The fact that this was the only cotton-related activity announced at the WTO meeting in Buenos Aires shows that trade officials have grown weary of talking about cotton.

Why Cotton is No Longer a Focus of WTO Talks

The fact that cotton is no longer central to talks in the WTO is partly a reflection of the reduction in subsidies in developed countries. Subsidies for cotton paid to farmers in the EU were mostly decoupled from current production decisions in 2006 and remain smaller than they were previously, and subsidies for cotton in the United States have fallen from between $3 billion and $5 billion a decade ago to about $1 billion today. Thus, subsidies paid to farmers in the EU and United States are no longer major sources of distortion to world cotton production and trade.

In addition, the structure of the world cotton market has changed fundamentally since the Hong Kong Ministerial was held in 2005. China is now the largest consuming country and India the largest producing country and second largest exporter. The major sources of distortion in world cotton production and trade today occur in China (the State Reserve) and India (Minimum Support Prices), but subsidies paid to farmers in developing countries are not a focus of discussion in the WTO.

Another reason cotton is no longer central to the WTO agenda is that the reform of trade policies in the cotton sector, coupled with development assistance (foreign aid) is not helping African farmers anyway. The premise underlying the talks on cotton in the WTO was that subsidies paid to farmers in developed countries led to oversupply and reduced market prices, thus harming the interests of African farmers. However, the Cotlook A Index, which averaged about 55 cents per pound between 2001 and 2005 when the Sectoral Initiative on Cotton in the WTO was launched, is currently above 80 cents. In addition, about $900 million in donor aid has been spent since 2004 or is committed under current projects in support of the cotton sector of Sub-Saharan Africa. Despite the rise in market prices and the support given to the cotton sector, the average yield across Sub-Saharan Africa of 330 kilograms of lint per hectare today is the same as it was two decades ago, and total production of about 1.5 million tons is the same as it was when the Doha Round started. So, why bother to focus on cotton if it is not going to do any good?

Implications

Cotton as an industry, and the C4 as a group, have had their moment in the diplomatic sun. That moment is passing. Trade negotiators are tired of talking about cotton. Donors are tired of funding cotton projects that don't do any good. Multilateral institutions like The World Bank, the Food and Agriculture Organization of the United Nations (FAO) and the United Nations Commission on Trade and Development (UNCTAD) are losing interest in cotton, and in commodity industries generally, and they are focusing on more generic issues such as women's empowerment and food security.

(The views expressed in this column are of the author and not that of Cotton Association of India)

COTTON EXCHANGE MARCHES AHEAD

Madhoo Pavaskar, Rama Pavaskar

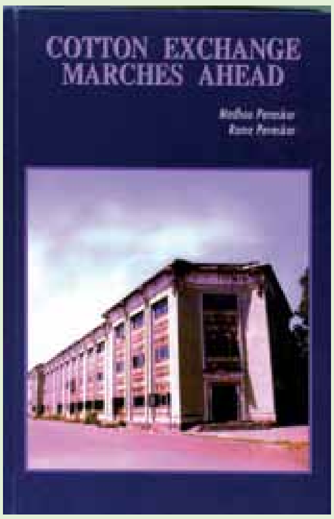
Chapter 7

Revival of Futures Trading

(Contd. from Issue No.36….)

Trading Regulations

Initially all the categories of these members who could participate in the ICC were called upon to pay heavy security deposits ranging from Rs.30 lakh for institutional members to Rs.1 lakh for brokers, besides substantial amounts of registration fees and annual subscriptions. In addition, they had to pay the clearing fees, transaction charges, brokerage, ordinary margins on purchases and sales beyond the prescribed free limits, etc. Apart from the members of the Exchange, non-members were also allowed to trade in the ICC, after due registration as "clients" on payment of the prescribed registration fees and annual subscriptions. Of course, the composite trading members or trading members through whom such clients traded, would demand from them the security deposits and margin monies.



As if all this was not enough, trading in the ICC was subjected to severe regulatory measures ab initio by the Forward Markets Commission (FMC). These included the minimum and maximum prices for the ICC, a limit of just 4 units per transaction at a time, the graded special margins on the purchases and sales at the progressively higher and lower price levels respectively as prescribed, a limit on daily price fluctuations, besides the daily clearing as provided in the by-laws of the Exchange.

As a result of these diverse trade regulations and market security measures (taken by the Exchange mainly at the behest of the FMC to avert the alleged counter-party risks and possible defaults), the hedge and speculative business at the Cotton Exchange was hardly cost-effective. The Exchange could attract only one institutional member, namely, ABN Amro Bank, which incidentally happened to be a clearing bank also. The number of members in all other categories together scarcely exceeded 15, whereas brokers were just 2 in number.

Alarmed by the negligible trading, the Cotton Exchange decided to keep its trading hall closed on all Saturdays. The trading hours too were gradually reduced to just 2 hours to intensify competition in the market. From August 2000, trading hours were changed to between 2.30 p.m. and 4.30 p.m. in the afternoon to enable the spot traders as well as others in the downtown to attend the trading ring at Cotton Green. By that time, the upcountry spot rates were also known, since these were fixed officially by the Daily Rates Committee after 1 p.m.

Trading on a Low Key

Trading in the cotton futures at the East India Cotton Association began on a low key from December 1998 with most potential players adopting a wait and watch attitude. During the cotton year 1998-99 (Oct-Sept.), the total volume of business transacted in all the delivery months traded at the Cotton Exchange was barely 75,000 bales, or just half a percent of the season's total crop. The open position did not exceed even 7500 bales at any time. In other words, even the maximum open position during the year was as low as one-twentieth of one percent of the corp. Clearly, contrary to the fears of the FMC, the futures market in cotton did not so much face the counter-party risks as lack of liquidity, which impaired the relationship between the physical and futures prices, and thereby affected adversely the utility of the ICC for both risk management and price discovery.

To improve the trading volumes, during the cotton season 1999-2000, the Cotton Exchange proposed a number of progressive changes and urged the FMC to approve them. The FMC readily gave its nod. The categories of market participants were rationalised and their number was brought down to just four by merging three categories of composite trading members, clearing members and clearing cum trading members into just a single category of composite members. The security deposits were substantially reduced for the categories of composite trading members, trading members and brokers; the free limits were raised and the tendering procedures were simplified. The FMC was also persuaded to reduce the special margin rates by half.

Meanwhile, the East India Cotton Association embarked on road shows at Ahmedabad, New Delhi, Bangalore and Coimbatore to introduce the ICC to the local cotton trade and textile industry and explain its utility for risk management to the diverse market functionaries, including the mills. The FMC also organised workshops and training programmes for the office bearers and the senior staff of the commodity exchanges at several places, including, Delhi, Ahmedabad, Chennai and Pune. For one year, the Cotton Exchange even experimented by appointing a few market makers who functioned like jobbers and offered two quotations simultaneously in the trading ring – one for purchase and the other for sale of the ICC. The scheme was evolved to facilitate trading in the ICC at all times.

These measures helped to some extent to improve the trading volumes in the ICC during the cotton season 1999-2000. The total futures business in all the delivery months traded during that season rose to a little over 5 lakh bales. But even that constituted less than 5 per cent of the crop. The open position scarcely exceeded 10,000 bales. The ICC also attracted deliveries of around 1200 bales during the season.

The improvement, however, did not last long. With low liquidity, the initial enthusiasm of most market players gradually began to wane, and in the cotton season 2000-01 the volumes as well as the open position once again dwindled. For quite a few days, the trading hall at Cotton Green was virtually deserted with just sporadic activity. As the New Millennium commenced, it appeared that the future of the ICC was in jeopardy. But the fault for this poor state of affairs did not really lay at the doors of the Cotton Exchange. The general realities with respect to the underlying physical markets were far from favourable for the development of active futures trading in cotton.

Roadblocks Galore

Futures markets in commodities like cotton do not function as independent entities. These markets are essentially adjuncts to the underlying physical markets, and are primarily aimed at performing auxiliary functions of risk management and price discovery for the latter. After all, physical goods hardly pass through the gates of a futures market. Nevertheless, insofar as futures prices help to serve as reference prices for the physical market transactions (especially forward delivery transactions), and assist in covering the price risks involved in such transactions, they facilitate orderly marketing and pricing of physical goods.

Unfortunately, as stated in the previous chapters, physical markets in cotton, for both ready and forward (of especially non-transferable specific type) deliveries, are as yet far from free and flexible. These are subjected to severe regulatory restrictions. Derivative contracts like "on call" and "unfixed" contracts are not permitted in physical markets for cotton. Consequently, under the Cotton Control Order issued under the Essential Commodities Act, 1955, most cotton contracts are statutorily required to be fulfilled by delivery of goods and payment of price within as short duration as only seven days. Such hand to mouth purchases and sales of cotton scarcely seem to need any hedging, as price risks involved in these transactions are ipso facto far too small or almost non-extant.

This is not all. Exports of cotton were regulated by small restricted quotas, which in turn, were mostly allotted to the public sector and state co-operative agencies, leaving a few crumbs for the private cotton trade. The public sector agencies like the Cotton Corporation of India at the all-India level, and the Maharashtra State Co-operative Cotton Growers' Marketing Federation, which had absolute monopoly in the procurement of unginned cotton, and sale of cotton lint drawn from it, in the entire state of Maharashtra, together took away quite a significant slice of the domestic trade in cotton.

Only on June 2, 2001, the Union Minister for Textiles, Mr. Kashiram Rana announced that all restrictions on cotton exports are being removed. But in 2000-01 Indian cotton was outpriced in the depressed international markets. The situation is not far different this year (2001-02) too. It may therefore take quite some more time before Indian cotton becomes competitive in terms of quality and price in the world markets.

Under such domestic and export marketing conditions, it would have been indeed a miracle, had the Indian Cotton Contract attracted large scale hedging. Moreover, options which provide the most effective instrument for risk management still remain altogether banned under the Forward Contracts (Regulation) Act. And, in the absence of hedging, it is not surprising that professional speculators too shun the ICC.

As it is, the roadblocks on the path of cotton futures are far more galore than one can count on one's fingers. To name a few, amongst these, one can do little better than quote explicitly from the presidential address of Mr. Suresh Kotak at the 78th Annual General Meeting of the East India Cotton Association. As he then listed, "some of the roadblocks that impede the progress can be identified as: (i) non-availability of the benefits of set-off of speculative loss against profits earned in other business; (ii) disallowance of the benefit of setting off of the losses from the outstanding futures contracts worked out on the basis of actuarial valuation against profits out of the contracts concluded upto the end of the financial year; (iii) proliferation of illegal futures trading at various centres without any check; (iv) varying rates of sales tax prevalent in different States; and (v) application of Essential Commodities Act to cotton", which dissuade cotton merchants and ginning and pressing factories from holding large stocks at any given time, reducing in the process their need for hedging.

These apart, actually there are in fact, many more impediments to the growth of cotton futures market. These included mostly operational and regulatory restrictions imposed by the Forward Markets Commission, which had rendered trading in the futures more costly and paradoxically even risky, with little compensatory returns. Added to these, under the existing rules governing the stock exchanges, the brokers and financial institutions registered with the stock exchanges are barred from joining and trading in the commodity exchanges, though many of these brokers were trading in commodity futures before their closure in 1960s. Not surprisingly, most commodity exchanges lack professional speculators.

Anyway, until the innumerable impediments and roadblocks are removed by the authorities, it may be difficult for the Cotton Exchange to promote futures trading by even having a second look at the specifications of the Indian Cotton Contract so as to render it more useful for both risk management and price discovery to the diverse market functionaries such as spinning mills, ginning and pressing units, farmers' co-operatives and upcountry cotton merchants. In fact, the Cotton Exchange might not be averse to take these different market functionaries, including the professional speculators, cotton brokers and commission agents, into confidence, while restructuring the Indian Cotton Contract, and even to have more than one futures contract, if necessary, to cover the hedging requirements and to facilitate price discoveries for all the diverse descriptions of Indian as well as imported cotton. At present, however, with roadblocks galore, both statutory and operational, to futures trading, any exercise at reforming the ICC by the Cotton Exchange is likely to prove fruitless and worthless. Any such attempt would simply result in putting the cart before the horse, and would take the ICC nowhere.

Nevertheless, to improve the practical utility of the ICC to some extent and encourage trading in it, the East India Cotton Association has in February 2002 reduced the unit of trading to 11 bales, and also restricted the delivery centres to 34 specified places in the nine major cotton growing States. The Forward Markets Commission has since then approved the necessary amendments to the by-laws of the Association made in these behalf.

(To be continued ......)

Production Of Man-Made Filament Yarn

(In Mn. kg.)

Year/Month	Viscose Filament yarn	Polyester Filament yarn	Nylon Filament yarn	Poly propylene Filament yarn	Total
2010-11	40.92	1462.28	33.46	13.14	1549.79
2011-12	42.35	1379.52	27.95	13.19	1463.01
2012-13	42.63	1288.15	22.91	17.18	1370.87
2013-14	43.99	1212.43	24.09	12.91	1293.42
2014-15	44.24	1158.20	32.55	12.77	1247.76
2015-16	45.41	1068.80	37.26	12.66	1164.13
2016-17 (P)	46.07	1060.41	41.00	11.45	1158.93
2017-18 (P) (Apr.-Oct.)	27.24	646.37	22.42	6.25	702.28
2015-16					
April	3.80	95.97	3.22	1.09	104.08
May	3.70	96.03	3.01	0.99	103.73
June	3.69	82.80	2.69	0.95	90.13
July	3.78	82.67	3.11	1.12	90.68
August	3.81	86.94	2.96	1.13	94.84
September	3.82	89.67	2.81	1.00	97.30
October	3.83	89.49	3.17	1.00	97.49
November	3.75	87.58	2.86	1.32	95.51
December	3.82	90.60	3.29	0.91	98.62
January	3.83	93.31	3.36	1.02	101.52
February	3.78	86.91	3.32	1.10	95.11
March	3.80	86.83	3.46	1.03	95.12
2016-17 (P)					
April	3.78	84.08	3.30	0.96	92.12
May	3.88	85.31	3.38	0.96	93.53
June	3.90	84.93	3.27	0.95	93.05
July	3.98	89.83	3.46	0.99	98.26
August	3.97	90.88	3.38	0.97	99.20
September	3.75	89.11	3.67	0.96	97.49
October	3.89	93.00	3.69	1.05	101.63
November	3.78	86.49	3.06	0.77	94.10
December	3.84	84.59	2.76	0.80	91.99
January	3.87	93.21	3.77	1.10	101.95
February	3.56	85.78	3.49	0.89	93.72
March	3.87	93.20	3.77	1.05	101.89
2017-18 (P)					
April	3.81	89.41	3.24	0.85	97.31
May	3.83	92.68	3.49	0.79	100.79
June	3.69	90.84	3.27	0.90	98.70
July	4.03	96.53	2.96	0.95	104.47
August	3.98	97.09	3.07	0.91	105.05
September	3.90	91.81	3.09	0.92	99.72
October	4.00	88.01	3.30	0.93	96.24

P - Provisional

Source : Office of the Textile Commissioner

UPCOUNTRY SPOT RATES

(Rs./Qtl)

Standard Descriptions with Basic Grade & Staple in Millimetres based on Upper Half Mean Length [By law 66 (A) (a) (4)]							Spot Rate (Upcountry) 2017-18 Crop DECEMBER 2017					
Sr. No.	Growth	Grade Standard	Grade	Staple	Micronaire	Strength /GPT	11th	12th	13th	14th	15th	16th
1	P/H/R	ICS-101	Fine	Below 22mm	5.0-7.0	15	11445 (40700)	11417 (40600)	11389 (40500)	11529 (41000)	M	11642 (41400)
2	P/H/R	ICS-201	Fine	Below 22mm	5.0-7.0	15	11642 (41400)	11614 (41300)	11585 (41200)	11726 (41700)	A	11838 (42100)
3	GUJ	ICS-102	Fine	22mm	4.0-6.0	20	8548 (30400)	8548 (30400)	8520 (30300)	8605 (30600)		8717 (31000)
4	KAR	ICS-103	Fine	23mm	4.0-5.5	21	9195 (32700)	9195 (32700)	9167 (32600)	9251 (32900)	R	9364 (33300)
5	M/M	ICS-104	Fine	24mm	4.0-5.0	23	10123 (36000)	10123 (36000)	10095 (35900)	10179 (36200)	K	10292 (36600)
6	P/H/R	ICS-202	Fine	26mm	3.5-4.9	26	10573 (37600)	10629 (37800)	10601 (37700)	10714 (38100)		10939 (38900)
7	M/M/A	ICS-105	Fine	26mm	3.0-3.4	25	9673 (34400)	9673 (34400)	9645 (34300)	9729 (34600)	E	9814 (34900)
8	M/M/A	ICS-105	Fine	26mm	3.5-4.9	25	10151 (36100)	10151 (36100)	10123 (36000)	10208 (36300)	T	10292 (36600)
9	P/H/R	ICS-105	Fine	27mm	3.5.4.9	26	10742 (38200)	10798 (38400)	10770 (38300)	10882 (38700)		11107 (39500)
10	M/M/A	ICS-105	Fine	27mm	3.0-3.4	26	9898 (35200)	9898 (35200)	9870 (35100)	9954 (35400)		10179 (36200)
11	M/M/A	ICS-105	Fine	27mm	3.5-4.9	26	10348 (36800)	10348 (36800)	10320 (36700)	10404 (37000)	C	10629 (37800)
12	P/H/R	ICS-105	Fine	28mm	3.5-4.9	27	10854 (38600)	10911 (38800)	10882 (38700)	10995 (39100)	L	11220 (39900)
13	M/M/A	ICS-105	Fine	28mm	3.5-4.9	27	10376 (36900)	10376 (36900)	10348 (36800)	10432 (37100)		10686 (38000)
14	GUJ	ICS-105	Fine	28mm	3.5-4.9	27	10686 (38000)	10686 (38000)	10657 (37900)	10742 (38200)	O	10995 (39100)
15	M/M/A/K	ICS-105	Fine	29mm	3.5-4.9	28	10629 (37800)	10629 (37800)	10601 (37700)	10686 (38000)	S	10911 (38800)
16	GUJ	ICS-105	Fine	29mm	3.5-4.9	28	10882 (38700)	10882 (38700)	10854 (38600)	10939 (38900)		11192 (39800)
17	M/M/A/K	ICS-105	Fine	30mm	3.5-4.9	29	10911 (38800)	10911 (38800)	10882 (38700)	10967 (39000)	E	11220 (39900)
18	M/M/A/K/T/O	ICS-105	Fine	31mm	3.5-4.9	30	11164 (39700)	11135 (39600)	11220 (39900)	11304 (40200)	D	11529 (41000)
19	A/K/T/O	ICS-106	Fine	32mm	3.5-4.9	31	11867 (42200)	11867 (42200)	11867 (42200)	11951 (42500)		12176 (43300)
20	M(P)/K/T	ICS-107	Fine	34mm	3.0-3.8	33	14847 (52800)	14988 (53300)	15129 (53800)	15269 (54300)		15691 (55800)

(Note: Figures in bracket indicate prices in Rs./Candy)