TESTIMONY
Presented by
John Pucheu, Chairman
on behalf of the
National Cotton Council
before the
United States Senate
Committee on Agriculture, Nutrition and Forestry

The National Cotton Council is the central organization of the United States cotton industry. Its members include producers, ginners, cottonseed handlers, merchants, cooperatives, warehousemen and textile manufacturers. While a majority of the industry is concentrated in 17 cotton-producing states, stretching from the Carolinas to California, the downstream manufacturers of cotton apparel and home furnishings are located in virtually every state.

The industry and its suppliers, together with the cotton product manufacturers, account for more than 230,000 jobs in the U.S. [U.S. Census of Agriculture]. Annual cotton production is valued at more than $5.5 billion at the farm gate, the point at which the producer sells [Economic Services, NCC]. In addition to the cotton fiber, cottonseed products are used for livestock feed, and cottonseed oil is used for food products ranging from margarine to salad dressing. While cotton's farm-gate value is significant, a more meaningful measure of cotton's value to the U.S. economy is its retail value. Taken collectively, the annual economic activity generated by cotton and its products in the U.S. is estimated to be in excess of $120 billion [Retail Values of U.S. Agricultural Commodities, NCC].

Mr. Chairman, thank you for holding this hearing and for allowing me to present the views and concerns of the members of the National Cotton Council. My name is John Pucheu. I serve as Chairman of the National Cotton Council. My brother and I own and operate a diversified farming operation in Tranquillity, California - a part of the highly productive San Joaquin Valley.

Mr. Chairman the U.S. cotton industry faces numerous and substantial challenges, which I will discuss in more detail. We are committed to work within the industry and with Congress and the Administration to successfully meet our challenges and remain a viable industry. We strongly believe that predictable farm policy is critical to our success and that new farm legislation should be based on the structure of the 2002 farm bill. The most important provision is a marketing assistance loan available on all production with an accurate world price discovery mechanism. A modest direct payment provides certainty to farmers and lenders. And, a counter-cyclical provision is necessary to provide support in times of low prices. We also support maintenance of adequate planting flexibility to allow producers to respond to market signals. We are opposed to payment limitations and we urge Congress not to make changes that reduce existing limits or further restrict eligibility.

Pima cotton producers support continuation of the extra-long staple cotton program. ELS cotton is an important alternative crop for growers in the irrigated Far West, particularly in California's San Joaquin Valley. The ELS program is an effective, minimal cost program providing support to producers and ensuring that Pima cotton is competitive in world markets.

We understand the budget challenge the Committee faces in crafting new farm legislation. We believe much of the success of the current law is the balance between commodities, conservation and nutrition programs. We urge the Committee to work to preserve that balance by maintaining the baseline for commodity programs.

Mr. Chairman, it is also important that government programs provide equitable levels of support across commodities. While there are a number of measures that can be used to compare levels of support, we believe the most appropriate measure is to compare support rates to the costs of production for each crop. Adequate support rates allow producers to secure financing for their expected production costs. The following table compares loan rates and target prices to total costs of production, as reported by USDA's Economic Research Service. We believe the comparisons demonstrate that cotton's level of support is in line with other commodities.

Table 1. Support Levels as Percent of Total Costs of Production

Loan Rate		Target Price	
Soybeans	89%	Peanuts	123%
Peanuts	88%	Cotton	113%
Corn	82%	Rice	113%
Cotton	81%	Corn	110%
Rice	70%	Soybeans	104%
Wheat	53%	Wheat	76%

The basic structure of current farm programs provides an effective safety-net, but cotton markets are changing so adjustments to the administration of the cotton marketing assistance loan will be necessary. In the interim, the industry is pro-actively working to address the challenges of a changing market. Last August, we worked with USDA as they developed an extensive regulation that modifies a number of components of the cotton marketing assistance loan. It allows relocation of bales under loan to better position them to move to market. The regulation also capped the monthly storage charges paid by CCC and requires warehouses to report shipping performance on a weekly basis. Recently, we asked USDA to assist a special Working Group that I appointed to thoroughly review the methodology used to establish loan premiums and discounts; to determine whether location differentials should be eliminated; and to determine how a more accurate world price can be discovered. The Working Group will also develop recommendations to add more flexibility in the way loans are redeemed so cotton can move to market more efficiently and competitively. We believe we can develop recommendations for adjustments that can be made to the statute administratively and which protect CCC's collateral and provide an effective safety-net for producers while cotton moves to market in a more timely manner.

Mr. Chairman, we also want to work with you and your colleagues to develop provisions which will assist our struggling domestic textile industry. According to USDA, domestic mill consumption of cotton is forecast at 5.0 million bales for 2006/07 (Figure 1). This is 900,000 bales or 15% below levels of a year earlier. The current projection for consumption will be less than 50% of levels just 7 years ago. It will be the lowest U.S. mill consumption since 1931/32. Quoting from a USDA analyst's report at the recent USDA Outlook Conference "...this dramatic decline in U.S. mill use has resulted from increased competition of imported textile and apparel products......... China is now the leading supplier of cotton textile and apparel products to the U.S. - accounting for nearly 20% in 2005 and growing rapidly." Even though textile imports have increased and domestic mill consumption has declined, cotton use at retail actually increased to 23.6 million bale equivalents in 2006 and will continue to increase in 2007 and the foreseeable future. U.S. consumers continue to drive global demand for cotton - thanks in part to the highly successful U.S. producer and importer-funded promotion program operated by Cotton Incorporated. U.S. per-capita consumption of cotton rose to 37.9 lbs in 2006. To place that in perspective, PCI Fibres places annual per-capita cotton consumption in the developed economies of Western Europe and Japan at just over 16 lbs, and USDA is currently estimating that China's consumers purchase only 5.5 lbs of cotton textile products annually.

U.S. mills are competing with heavily subsidized imports without a safety net. In recent months, it has been stated and re-stated that the U.S. needs a robust and viable renewable fuels production base protected by a tariff and tax credit. We support that policy because it clearly benefits farmers and is in the interest of U.S. security. But downstream users of cotton are not afforded the same level of protection and assistance. Their primary protection was traded away during the Uruguay Round of trade negotiations and may be further eroded in the Doha round. As a result, we need to provide assistance to our domestic customers - this country's textile production base. We recommend competitiveness assistance to U.S. mills for every pound of cotton they consume. This modest program would have very low costs and could be offset by minor modifications to other aspects of the cotton program.

Mr. Chairman, I want to also make a few comments about the Administration's farm bill proposal. We are pleased that it recognizes the importance of maintaining the structure of current law. We also appreciate the recommendation that the marketing assistance loan continue to operate without onerous, unworkable limits. But we are deeply concerned by the proposal to implement a loan-rate formula that would result in a sudden, precipitous drop in the cotton loan rate.

We understand that the proposal to significantly increase the direct payment is designed to compensate cotton producers for the lower loan in a WTO compliant manner - but it doesn't do an adequate job. Replacing an important component of our policy that is available on actual production with a decoupled payment based on ancient history doesn't offer adequate compensation - especially to growers in the Southeast and to new growers in places like Kansas and northern Texas.

We are also concerned by the proposal to terminate the 3-entity rule, which has been in place since 1989 when it was viewed as a significant compromise. If we could be assured that the termination of the 3-entity rule and implementation of direct attribution would be paired with the new limits by the Administration - though they still disproportionately impact high value crops produced in high cost, highly productive areas, it might be worth considering as a means to simplify compliance and administrative burden. However, the clear danger is that the 3-entity rule will be terminated and limits will remain at current levels. We also ask for careful consideration of how husband and wife eligibility is to be determined, continuation of the landowner exemption, and an extension of current rules to determine if an individual is actively engaged in farming.

We strongly oppose the Administration's proposal to modify the existing adjusted gross income (AGI) test by dropping the level to $200,000 and eliminating the exclusion for those who earn 75% or more of their income from farming, ranching or forestry. Congress added a $2.5 million AGI test to the last farm bill in response to media criticism that high-income individuals - namely Scotty Pippin and Ted Turner - were receiving farm program payments. This was to ensure that individuals who depend on farming, ranching or forestry for their livelihood were not penalized. The Administration contends that less than 2% of Americans who file tax returns have an AGI greater than $200,000. The Administration also contends that 4.2% of recipients of farm program payments who filed a Schedule F in 2004 have an AGI above $200,000 and that only 4.7% of all payments received by farm proprietors went to those with an AGI over $200,000. That is catchy spin, but dangerously misleading. The real question is what percent of U.S. commodity production will be affected. For cotton, we believe it will be very significant.

Perhaps the most troubling aspect of the new AGI test is that it subjects growers and their lenders to the ping-pong effect of "in one year and out the next" which is directly at odds with the Secretary's call for "predictable" farm policy.

We were also disappointed by a provision in the Administration's FY08 budget proposal to eliminate cotton storage credits when prices are low. Cotton, with a few exceptions, must be stored in an approved warehouse to be loan eligible. The practice of covering storage was put in place to ensure cotton was available at competitive prices. If the Administration's budget proposal is accepted, the practice of covering storage when prices are low would be terminated effective October 1, 2007, just as 2006 crop loans are maturing. This would effectively change the terms of the loan after they were made and result in significant market disruption and income losses to farmers. Inexplicably, the Administration proposed eliminating the storage credits in their FY08 budget proposal, but not in their farm bill proposal.

Access to an affordable crop insurance program is an important tool for most farmers. However, given the continued inequities of coverage and service in different regions and for different crops, it is time for a thorough evaluation of the cost and benefits associated with the multi-peril crop insurance program. The cotton industry would also be interested in exploring enhancements to crop insurance products that would offer protection on an individual's deductible. The Administration included the concept of supplemental insurance coverage in their farm bill proposal, and many growers are interested in further analysis to identify an effective program that would help mitigate production risk.

The National Cotton Council believes conservation programs will continue to be an important component of effective farm policy. The Conservation Security Program, Conservation Reserve Program and Environmental Quality Incentive Program are examples of proven, valuable ways to promote sound, sustainable practices through voluntary, cost-share, incentive-based programs. However, they are not an effective substitute for the safety net provided by commodity programs. We must maintain an equitable balance in conservation and commodity spending for the development of new farm policy. Furthermore, we support eligibility provisions for conservation programs that are as consistent as possible with commodity eligibility provisions.

Continuation of an adequately funded export promotion program, including the Market Access Program (MAP) and Foreign Market Development (FMD) Program, are important in an export-dependant agricultural economy. It also is valuable to maintain a WTO-compliant export credit guarantee program. Individual farmers and exporters do not have the necessary resources to operate effective promotion programs which maintain and expand markets - but the public-private partnerships facilitated by the MAP and FMD programs, using a cost-share approach, have proven highly effective and have the added advantage of being WTO-compliant.

Mr. Chairman in concert with development of effective farm policy, U.S. trade negotiators must send a clear signal that enough is enough. The U.S. should not continue to provide more concessions (often unilateral) while receiving virtually no positive indications from our trading partners that they will also move down the trade liberalization road. The strong stand by the U.S. in Geneva last July was fully appropriate. Unfortunately, the U.S. seems to have been apologizing ever since. The U.S. must not make additional concessions on domestic support until our market access objectives are met and exceeded. The U.S. should not agree to a Doha result that effectively exempts China - the fastest growing economy in the world - from concessions. The U.S. should not make further inequitable concessions on cotton beyond those made in Hong Kong which includes providing duty-free, quota-free access to cotton imported from developing countries. We appreciated the strong message conveyed to U.S. negotiators in a letter authored by Senators Conrad and Craig and signed by 58 Senators. The message was consistent with an earlier letter and is appreciated by U.S. cotton producers.

The Secretary frequently cites the Brazil cotton case as evidence that the U.S. farm law must be changed in order to be unchallengeable. The truth is that U.S. farm law can always be challenged under current WTO rules and there are no concrete signs that a new farm bill or a new Doha Agreement will change this.

Mr. Chairman, I would like to conclude some brief comments about our concerns with sluggish U.S. cotton sales, high levels of cotton under loan and persistently low prices. Total export commitments to China for the 06/07 marketing year stand at only 3.0 million bales, down 5.0 million bales from last year's number of 8.0 million bales. Unfortunately, China appears to be rationing access in order to maintain prices for her domestic producers. As a consequence, U.S. cotton exports to China are down significantly.

It is the case that cotton still under loan is above the levels observed at this same time in past marketing years. As of early-April, there were 10.6 million bales of the '06 crop of upland cotton still under loan. In recent years, cotton under loan in April averaged about 4.0 million bales. However, it is very important to note that 7.2 million bales of the '06 crop have already been redeemed from the marketing loan. This suggests that the loan is not the market of last resort and that cotton is not locked in the loan. Simply put, there is more cotton in the loan because of the lack of demand from key export markets. When demand improves, cotton will move out of the loan to satisfy that demand.

Instead of assigning undue blame for the current market situation to the cotton program, it is more appropriate to focus on the reasons why U.S. export sales have been lagging. First, as I previously mentioned, the loss of the Step 2 program has hurt the competitiveness of U.S. cotton. The U.S. has a smaller presence in the world market as a result of the loss of Step 2. Second, subsidies, trade restrictions, and other actions are having significant impacts on world cotton trade and prices - and frankly, are having a much greater impact than the remaining provisions of the U.S. cotton program. This second point is well supported by several statements made by USDA analysts in their report prepared for the recent USDA Outlook Conference.

"A combination of moderately higher world production and sharply highly world consumption is reducing world stocks for the 2006/07 season. Significant increases in production for China, India, Brazil and Turkey will more than offset reduced production in the United States, Australia, Greece and Syria."

"For India, both area and yields rose in 2006/07 from the year before, as the ongoing adoption of genetically engineered Bt cotton continued transforming cotton authorization across the country. Since much of the Bt cotton planted in India is illegal, estimates of the extent of Bt adoption vary widely."

"Higher production is also expected in Pakistan in 2007/08 as more normal weather and the spread of Bt cotton boosts yields. Commercial cultivation of Bt cotton is not legal in Pakistan, but has reportedly spread to several 100,000 hectares."

"Production in West Africa's Franc Zone in 2007/08 is likely to be about unchanged compared with the year before cotton prices were higher in U.S. dollar terms during the first half of marketing year 2006/07, but for the Franc Zone, this was offset by the strength of the Euro versus the U.S. dollar. A rebounding EU economy drove the Euro 8 percent higher with respect to the dollar, and the CFA Franc is linked to the Euro."

"China imported a record 19.3 million bales in 2005/06; however, imports for the first half of the current season have fallen well short of the year ago level. The primary factor slowing the pace of imports appears to be government-imposed import quotas, which have been more restrictive thus far this season than last. In January 2007, the WTO TRQ of 894,000 tons (4.1 million bales) was released; however, because a portion of the quota is reserved for state enterprises, it has not all been allocated to mills."

"China has used a sliding scale import duty on non-WTO TRQ imports that attempts to assure a minimum import price to help support the domestic price for cotton."

"The apparent goal of the more restrictive import policies is to use domestic cotton first before allowing significant imports. The government imposed constraints on imports have made it difficult to ascertain the underlying demand from the world's largest cotton consumer, and importer; thus in turn, has resulted in unusual uncertainty for the world cotton market."

"The [U.S.] cotton product trade deficit in 2006 expanded to a record 18.1 million bale equivalents, more than double the trade deficit of just 8 years ago. During 2006, U.S. cotton textile and apparel imports reached the equivalent of 22.8 million bales of raw cotton, 4 percent above 2005. In contrast, cotton product exports decreased slightly to 4.7 million bale equivalents in 2006, and now account for 86 percent of U.S. cotton mill use compared with 55 percent in 2002."

"China's extensive and complex system of import quotas and government cotton reserves has limited the correlation between price movements in China and the rest of the world in 2006/07."

"Subsidies to cotton producers are also being put in place in China, and the Government has frequently intervened in local markets, buying cotton for the government's reserves."

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".....Beijing has announced a subsidy for the purchase of good quality planting seed...this is part of an overall package for agriculture valued at 8.87 billion Yuan....a massive increase of 48.6 percent over last year......for cotton, farmers in eight regions will benefit....the funds earmarked will be sufficient to pay the subsidy on 40 percent of prospective plantings."

Mr. Chairman, as previously noted, export markets now account for approximately 75% of total disappearance of U.S. cotton. Exports, and subsequently total use, can be highly variable, particularly within the marketing year (Figure 2). The industry recognizes the pressures that a highly-variable demand situation can place on the storage and distribution system. Through cooperation with USDA, the cotton industry is working to improve the flow and efficiency of the system to ensure that we remain the supplier of choice to the world cotton market. In a market environment with a high level of variability and uncertainty, I will reiterate the importance of the safety net provided by an effective farm program. The farm program provides the necessary stability to make the long-term investments that will keep the industry competitive and productive.

I will conclude my testimony by apprising the Committee of the Council's assessment of U.S. cotton acreage. In recent years, cotton acreage in the U.S. has fluctuated between 13.5 and 15.5 million acres as farmers have adjusted acreage based on agronomic practices and relative returns between cotton and competing crops. For this year, we fully expect that the surge in corn and soybean prices will cause producers to adjust their crop mix, and cotton acres will decline. The Council's acreage survey, conducted in late December and early January, reported cotton acreage intentions at 13.2 million acres - a 14% decline from last year's level (Figure 3). Of course, since the time of the survey, corn and soybean prices have increased further, and the actual cotton acreage decline will likely be even greater. USDA's recent Prospective Plantings report estimated cotton acreage at 12.1 million, down 20% from last year. This year's acreage adjustments are a clear indication that planting flexibility works and farmers are responding to market signals.

Mr. Chairman, thank you for the opportunity to testify today. I will be pleased to respond to your questions.