

COTTON TRADE IN THE LIGHT OF INTERNATIONAL AGREEMENT ON TRADE ON COTTON FIBERS

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International Cotton Trade Scenario

Trade in textiles and clothing is a vital part of the world economy, with many nations heavily dependent on this sector for foreign exchange earnings and employment-generation. Textile and clothing trade accounts for nearly 6% of total world exports. It was valued at US\$ 342 billion in 2001; trade in clothing accounted for 60% of this total. International trade is particularly important for cotton, since 30 percent of the world's consumption of cotton fiber crosses international borders before consumption by textile mills: The world's four largest cotton producing and consuming countries are China, the United States, India, and Pakistan. Together, these four account for around 60 percent of world production and consumption. The next three largest consuming countries are Turkey, Brazil, and Mexico, all of which produce cotton but are often large importers nonetheless. Cotton is mostly a Northern Hemisphere crop, but about 10 percent of the world's output comes from south of the equator—primarily Brazil and Australia.

Developed countries account for more than 40 percent of global consumer end-use of cotton, but only about 22 percent of the industrial use of raw fiber. Thus, about 20 percent of world cotton end-use is exported from developing countries to other developed countries. Both production of cotton and its export patterns are distorted very considerably by subsidies to both as well as by tariffs on cotton, textiles and clothing imports. Cotton usage, on the other hand, is distributed across countries roughly in proportion to their volumes of textile production.

India, the world's third-largest producer of cotton and second-largest producer of cotton yarns and textiles, is poised to play an increasingly important role in global cotton and textile markets as a result of domestic and multilateral policy reform. India is also an important global producer and consumer of synthetic fibers, ranking fifth in global production of synthetic fibers. Exports of yarns, textiles, and clothing to the world market are an increasingly important source of derived demand for Indian cotton.

Developed country consumers will, however, consume more cotton products, and developing country textile mills will consume more cotton fiber. India, the world's third-largest producer of cotton and second-largest producer of cotton yarns and textiles, is poised to play an increasingly important role in global cotton and textile markets as a result of domestic and multilateral policy reform. Liberalization of industrial and trade policies in the early 1990s increased the competitiveness of much of India's industry and service sectors, sparking robust growth in output and consumer demand.



Impact of elimination of MFA

On January 1, 2005, developed countries removed import quotas on textile products previously sanctioned by the 1974 Multifiber Arrangement (MFA). This change provides a major opportunity for India to expand production and exports of textiles and apparel to developed country markets. The elimination of MFA quotas induced Indian policymakers to relax investment restrictions and to adopt market liberalization measures in the textile sector, although these reforms have been slower than developments in some other key countries, most notably China. However, the opportunity created by the elimination of MFA quotas, together with India's rapid economic growth and demonstrated comparative advantage in production of both raw cotton and textiles, increases the likelihood that India will continue to adopt policies aimed at expanding its capacity to produce and export cotton and textiles. In the post-MFA era, developments in India and other developing countries that export textiles will have important implications for the United States and other cotton-exporting countries. India has already emerged as a small but growing market for U.S. cotton in recent years, driven by the price and quality consciousness of export-oriented mills and garment makers. India has, historically, been a competitive producer of raw cotton and mostly self-sufficient. It is not clear, however, if domestic producers will be able to meet the quantity and quality demands of a rapidly expanding textile sector that, according to government targets, aims to more than triple its exports by 2010. India is one of the largest consumers of cotton in the world, ranking second to China in production of cotton yarn and fabrics and first in installed spinning and weaving capacity.

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The impacts of MFA quota removal are analyzed based on the terms of the Agreement on Textiles and Clothing, which called for the removal of all quotas by January 2005. The package of domestic reforms analyzed included removal of restrictions on imports and exports of cotton and cotton-based products and removal of the Hank Yarn Obligation. These reforms were assumed to lead to an increase in labor productivity in India's apparel sector to levels achieved by China. The results of the analysis indicate substantial increases in output and net exports of textiles and apparel as a result of the package of domestic reforms, resulting in total annual welfare gains of about \$810 million. Gains are particularly large for cotton-based products, and percentage increases in output and exports of cotton-based products exceed increases in raw cotton output. The estimated benefits of domestic reforms are increased substantially when the impacts of MFA quota removal are included. With MFA quota removal and domestic reform, annual welfare gains more than double to \$1.97 billion



Staple wise characteristics of Cotton Produced

India is unique among major cotton-producing countries because a broad range of agro-climatic and soil conditions permit cultivation of all varieties and staple lengths of cotton. Indian and international standards use different staple length definitions for classifying cotton. By Indian standards, about one-half of Indian cotton is medium staple length, but, by international standards, only about one-quarter of Indian cotton is considered medium staple. The North zone tends to produce mostly short and medium staple varieties, the South zone mostly long and extra-long staples, and the Central zone a range of medium and long staple varieties.

India has the capacity to produce the full range of staple lengths of cotton needed to meet the needs of its textile industry. And India's hand-picked cotton is considered superior to mechanically harvested cotton in terms of sheen of finished fabric, amenability to spinning, tensile strength, etc. India, however, has significant problems in meeting other quality needs. In particular, Indian cotton is generally contaminated with other fibers and foreign matter and often consists of admixtures of multiple varieties with different fiber characteristics. These problems reduce efficiency (yarn by staple length realization) in the spinning process and result in higher levels of yarn impurities and imperfections. Problems with contamination and other quality attributes of Indian cotton have been a key factor behind the upward trend in cotton imports by India's export-oriented textile mills since the late 1990s. The risk associated with the unreliable quality of domestic cotton leads some textile producers to prefer imported cotton to meet export orders that demand consistent quality. The significant problems with admixture of varieties and contamination stem from practices on farms and in market yards that are not amenable to quick solution. Improvements in quality require better on farm seed management; improved technology of handling, transportation, and ginning; investments in market infrastructure; and a marketing system that provides price premiums that reflect the costs of supplying quality cotton. Accomplishing these changes will likely require implementation of grades and standards for domestic cotton and improvements in marketing that provide adequate incentives to producers, ginners, and traders to adopt quality-related practices. Demand for cotton and manmade fibers in India will likely rise as a result of strong growth in incomes in India, as well as increased Indian exports of textiles and apparel associated with the end of MFA quotas. Imports of raw cotton have increased in concert with rising demand in recent years, but future growth will depend on the extent to which India can boost chronically low cotton yields and improve cotton quality. The end of MFA quotas is likely to result in significantly faster growth in India's exports of cotton-based textiles and apparel.

The advent of Bt cotton, which appears to be yield enhancing and is being adopted rapidly, should lead to significant gains in production in the medium term. The combination of erratic moisture conditions in rainfed producing areas and weak institutions for delivery of seed, technology, and other inputs seem equally likely to slow the pace of productivity growth. In addition, meeting rising demand for quality cotton—particularly contamination-free cotton—will require changes in the cotton supply chain that are unlikely to be implemented quickly. To the extent that textile and apparel exporters, such as India, can meet rising export demand with domestically produced cotton, the elimination of MFA quotas is likely to lead to diminished prospects for net cotton exporters, such as the United States. Recent yield increases in



India, due in part to Bt technology, may signal slower growth in cotton imports in the medium term as the technology is more widely adopted. However, the quality needs of India's export-oriented textile firms will likely sustain a market for quality cotton for the foreseeable future. Market shares for the Indian cotton market appear to be sensitive to both price and quality. U.S. cotton, with a reputation for consistent quality, can maintain its market share provided it remains price competitive.

India's Productivity: Although India has lower labor costs than China, the higher productivity of labor of China makes the latter more competitive. Thus, the magnitude of India's market share will depend on its ability to make its production more efficient.

Political Uncertainty: Under conditions where there is political uncertainty in the trade relationship among major supplying and demanding countries, retailers may choose to diversify the country origin of their suppliers to minimize risk. In particular, continued political uncertainty and concerns about the possibility of the United States suddenly imposing trade protections on Chinese imports tend to temper desire to source production in China. Thus, India will benefit vis-à-vis China to the extent that its trade relationship with the United States and European Union is seen as more stable.

Winners: India and Pakistan

Most experts believe that the Indian textile industry will be able to compete reasonably well in the post-MFA world, and general opinion is that India will be better off than other South Asian countries. At the same time, experts in the region believe that India will not be as competitive as China. India's inability to compete with China is mainly attributed to the absence of technological progress and to rigid labor laws. Pakistan, on the other hand, is not seen as a clear winner from MFA expiration. It does, however, appear to have a great deal of potential to be a winner. Both the Pakistani government and the private sector appear to be ready to take advantage of Pakistan's domestic production of cotton and low labor costs in order to achieve potential gains post-MFA

Post-multi fibre arrangement scenario

In the post-Multi Fibre Arrangement (MFA) era w.e.f. January 1, 2005, the textiles exports are up by 25per cent in 2005-06 over 2004-05 The share of textiles exports in USA imports have increase from 4per cent to 5per cent in calendar year 2005 as compared to that achieved in calendar year 2004.The share of textiles exports in extra- EU imports increased from 6per cent to 7per cent in calendar year 2005, growing at 18per cent year-on-year basis as compared to 5.6per cent growth in extra-EU imports. The country in calendar year 2005 was the third largest supplier of textiles to USA and EU.

Some of the deficiencies in the cotton sector identified include:-

- Weak machinery for supply of good quality seed.
- Poor productivity.
- High cost of cultivation
- Poor quality of seeds and pesticides



- Multiplicity of cotton varieties leading to rampant mixing
- Poor fibre attributes of most varieties of cotton
- Tardy transfer of agricultural technologies to the farmers' fields
- Unhygienic handling of harvested cotton at the farms
- Poor infrastructure at market yards
- High Trash content in cotton (6%-8%) despite being handpicked from the farms
- Wide range of contaminants in cotton numbering over 20 types

Imports will account for about one-third of world use of all cotton (upland and extra-long staple) in 2004/05. This share is expected to remain relatively stable over the next 10 years, and world cotton trade in 2014/15 is forecast at 38.3 million bales, almost 20 percent higher than in 2004/05. For hundreds of years, importing countries have accounted for much of the world's cotton spinning and, as late as 1979, the imported share of the world's cotton spinning reached 46 percent. Later, spinning shifted to countries that grow rather than import cotton, and only 28 percent of global cotton spinning used imported cotton in 1998. More recently, major cotton growers, like China, have also become significant importers, raising the imported share of consumption once again. Economic growth primarily determines demand for cotton products. Changes in taste are also a factor, and both consumer preferences and government policy can shift consumers' preference for various fibers. In China and India, strong economic growth and income gains coincided with declining household consumption of cotton products for long periods in the last few decades as domestic policies encouraged rapid growth in chemical fiber production and use. In other cases, such as in Russia and Eastern Europe during the 1990s, income clearly influenced both total textile purchases and cotton's share of households' textile purchases, as falling incomes coincided with a sharp drop-off in household cotton product consumption.

The country's cotton textile industry is looking up to research institutes and cottonseed manufacturers for new varieties of extra long staple cotton (ELSC) to improve availability of finer quality cotton. Domestic production of this cotton variety is just one tenth of the current demand and there are fears that once the US Government withdraws subsidy to its cotton cultivators, ELSC prices would shoot up in the international market. The US is one of the largest producers of this fine-quality cotton. With no improvement in domestic production of ELSC, the country might be forced to import its entire requirement in the next five years. He conceded that private cottonseed manufacturers might not be keen to develop new varieties owing to the bigger demand for coarser varieties of cotton. The demand for ELSC is expected to remain stagnant at around 15 lakh bales. India is a growing import market for extra long staple (ELS) cotton and high quality long staple cotton (28-32 mm). Imports of medium staple cotton occur when local supplies are tight and/or when world prices are favorable. Gains are particularly large for cotton-based products, and percentage increases in output and exports of cotton-based products exceed increases in raw cotton output. The removal of these quotas is expected to affect the geography of textile production more than the level of worldwide consumption. Fuelled by textile demand, cotton and man-made fiber demand at the mill level is likely to go up by 13 and 72 percent, respectively. Furthermore, prices of cotton and polyester are projected to rise by 23 and 13 percent, respectively. Cotton production, on the other hand, is



expected to increase by 19 percent. Overall, the baseline suggests increase in cotton imports by the Indian textile mills in the next ten years. The results suggest higher domestic cotton prices (as much as 22 percent) and acreage expansion of cotton (from around 1 percent to 5 percent) in all the three regions, but the supply increase does not appear to be enough to meet rising mill demand under the scenarios of higher textile exports. The rise in cotton imports from India appears to have little effect on world cotton prices. Most of the increase in world price is expected in the years immediately (2004/05 -2007/08) after quota eliminations.

Big gains for India

Currently, global textile and apparel exports are just short of \$500bn a year. To put this in perspective, India's national income is just over \$500bn; Bangladesh's and China's close to \$50bn and \$1,300bn respectively. With the quotas gone, total global exports are expected to cross \$1,200bn by 2010. Shifts in shares of this huge industry can lift entire nations out of poverty and, equally, plunge regions into joblessness. While the gains for China are certain and enormous, India is also expected to reap substantial benefits. In the first six weeks of the quota-less world, India has made big gains. Currently India exports \$14bn worth of textile products. Even without doing much it should reach an export of \$40bn by 2010. But, with a proper blend of policies, it is possible to reach the figure of \$80bn. This, apart from the benefit of bringing in foreign exchange and boosting growth, could make a visible dent on unemployment. For Bangladesh and Pakistan, which rely on textiles for about 70% of their export earnings, it will be harder struggle but they - especially Bangladesh - could also benefit from a quota-less world. All these countries have cheap labour; the additional advantages that India has are those of size and large foreign-exchange reserves that can (and, I believe, should) be used to boost infrastructure. With the completion of phasing out of the Multi-fibre agreement (MFA) by 1st January 2005, India's share in total world textiles and garments exports is poised to reach 8.0% by 2010 from the present 3.9% to become \$50 billion sector. Due to its inherent cost and operational advantages, India is set to pocket a larger share of the world textile and garment export market which is projected to grow to about \$ 655 billion by 2010, from \$ 400 billion presently.

Future Challenges

- Sustained yield improvement
- Yield stability
- Reduced input costs
- Value-added fiber (improved fiber quality)
- It is entirely driven by changes in the competitive environment and consumer preferences. World demand for fiber is growing at a rapid pace, far greater than the world population growth rate. Unfortunately, more and more of the demand is being met by synthetic manmade fibers.
- For cotton to remain a viable and profitable crop, it must successfully compete with engineered synthetic fibers.

