Untangling China’s Cotton Policy

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China’s price floor led to huge cotton stockpile

- China announced a price floor for cotton for MY2011 that exceeded world price
- Price floor raised higher in MY2012
- Stockpiled approximately 50% of MY2011 and 80% of MY2012 crop. Stockpile is now about 50% of global use.
- China’s cotton and yarn imports surged, supporting global prices
- Chinese textile industry under financial pressure...idle factories and bankruptcies are reported
- There is no clear plan for disposing of excess cotton inventory
Price floor announced while prices were at a peak. Price floor increased again in MY2012

China cotton prices, 2010-13

Source: ERS analysis of data from Beijing Cotton Outlook, Cotlook, Ltd., and International Monetary Fund.
China cotton policy background

- Market intervention through reserve management, import quotas, but no explicit price set during 2000-10.
- Small subsidies for cotton producers beginning 2008 contributed little to income or incentives.
- Concerns about instability in cotton production and price and maintaining a degree of self-reliance.
- Unrest in Xinjiang region (half of cotton output).
The cotton price floor policy

• Multiple objectives: rural income, production incentives, social stability, industry stabilization
  – Farmers wanted a price floor
• reflects “price formation” strategy
  – Based mainly on production costs plus profit
  – Set to maintain cotton-grain price ratio
  – International prices lower priority consideration
Authorities adopted a general strategy of raising support prices

China support prices for wheat and rice, 2004-2013

Other commodities:

“Temporary reserves” and price floors for corn, soybeans, rapeseed began 2008-09.

Hog price stabilization system in 2009.

Cotton “temporary reserve”, Floor price in 2011.

Source: ERS analysis of information from China National Development and Reform Comm
Cotton price floor was set unusually high

- Cotton price floor was set at 10 times wheat price (wheat is an alternative crop for cotton producers)
- Recent average price ratio was 8.4:1
- Ministry of Agriculture analysts recommended ratio of 8.5:1

Source: ERS analysis of data from Beijing Cotton Outlook and National Grain and Oils Information Center
Did Chinese authorities expect high cotton prices to persist?

Source: ERS analysis of data from Beijing Cotton Outlook and National Grain and Oils Information Center.
A large rebound in demand for Chinese cotton seems unlikely considering recent trend.

Source: ERS analysis of USDA PS&D data.
High cotton price reduces odds of rebound in demand that would absorb China’s inventories

- China’s textile industry competitiveness declining due to rising costs
- China’s imports of yarn prompted by high cotton price
- Substitution of chemical fiber for cotton yarn in China accelerated

Source: ERS analysis of data from International Cotton Advisory Committee
Multiple policy objectives rule out reduction in cotton price

- Rural income growth is a priority—especially in Xinjiang where unrest is a risk
- A decrease in production would reduce self-sufficiency
- “Price formation” strategy rules out price decrease
  - Production costs continued to rise in 2012
  - Increases (7-10 percent) in competing crop prices (wheat and rice) for 2013 already announced
Rising opportunity cost of rural labor influences net return for cotton

China cotton production costs and returns, 2006-11

Source: ERS analysis of data from National Development and Reform Commission.
Production in eastern regions is likely to fall; Xinjiang stable

China cotton farmer planting intentions, 2013

Xinjiang (northwest region)

Yangtze River (south central)

Yellow River region (north central)

Increase planting  Unchanged  Decrease  Undecided

Source: ERS analysis of data from China Cotton Association.
No clear indication of future policy

• Buyers have shown little interest in auctions of cotton from reserves due to its high price
• Could an increased subsidy payment be offered to compensate Chinese farmers for a lower cotton price?
  – Would have to be large subsidy; administratively difficult to implement.
• Could a deficiency payment (target price) subsidy decouple cotton support from textile competitiveness?
  – Experiment with soybean deficiency payment reportedly is under consideration
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